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DRAWEE BANK'S LIABILITY FOR WRONGFUL DISHONOR: A PROPOSED CHECKHOLDER CAUSE OF ACTION

MICHAEL D. SABBATH*

INTRODUCTION

In an article written almost 60 years ago, a commentator observed:

If the question were put to the average layman whether the holder of a check . . . had any effective rights against the drawee bank, it is believed that the almost universal response would be to the effect that of course the holder may insist upon payment by the bank, if there are funds on deposit to cover the amount. And if the same question were propounded to the average lawyer, the reply would be—at least if the lawyer had in mind the provisions of the Uniform Negotiable Instruments Law—that the holder had no rights against the bank.¹

Although the Uniform Commercial Code has replaced the Uniform Negotiable Instruments Law (the NIL),² the above observation still holds true. In recent years, courts have held almost uniformly that in the absence of certification or acceptance of a check or some other special circumstances a drawee bank has no obligation under

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¹ Aigler, *Rights of a Holder of Bill of Exchange Against the Drawee*, 38 HARV. L. REV. 857, 857 (1925).

² See U.C.C. § 3-101 official comment (1978). The official comment to section 3-101 provides: "Article [3] represents a complete revision and modernization of the Uniform Negotiable Instruments Law." *Id.* Notwithstanding this broad statement, the changes in the Code are few in number and include much of the language used in the NIL. Penney, *A Summary of Articles 3 and 4 and Their Impact in New York*, 48 CORNELL L.Q. 47, 48 (1962). The primary purpose of Article 3 was to counteract the lack of uniformity in the application of the NIL to negotiable instruments throughout the United States, and to limit the scope of the legislation to commercial paper. *Id.* at 49-50. Official comment 1 to section 3-103 defines commercial paper as "drafts, checks, certificates of deposit and notes" U.C.C. § 3-103 official comment 1 (1978).

the Code to a checkholder to pay a check drawn upon itself.³ It makes no difference that, at the time the check is presented for payment, the bank has sufficient funds of the drawer on deposit to pay it.⁴ Thus, while the drawer "customer" clearly has a cause of action under the UCC against his bank for wrongful dishonor of a check,⁵ it has been conceded that the checkholder does not have a similar cause of action against the drawee bank.⁶

Of course, when the drawee refuses to honor a check, for whatever reason, the holder⁷ usually has recourse on the instru-

³ See, e.g., *Conn v. Bank of Clarendon Hills*, 53 Ill. 2d 33, 38, 289 N.E.2d 425, 428 (1972) (holder of check has no cause of action against drawee bank for wrongful dishonor under § 3-409(1)); *Galaxy Boat Mfg. Co. v. East End State Bank*, 641 S.W.2d 584, 586 (Tex. Civ. App. 1982) (drawee bank not liable to payee on check until drawee bank accepts or certifies the instrument); see also 5A C. ZOLLMAN, *BANKS AND BANKING* § 204, at 544 (perm. ed. 1973) (absent privity of contract, payee may not recover from drawee bank) [hereinafter cited as *BANKS AND BANKING*]. Courts have interpreted sections 3-409 and 4-402 to bar any cause of action for wrongful dishonor against a drawee bank that has neither accepted, nor certified, the check presented to it. See, e.g., *Bon Bon Prods., Ltd. v. Xanadu Prods., Inc.*, 32 U.C.C. Rep. Serv. (Callaghan) 253, 257 (D. Mass. 1981) (§ 4-402); *Shreveport Prod. Credit Ass'n v. Bank of Commerce*, 405 So. 2d 842, 845 & n.3 (La. 1981) (§ 3-409). Moreover, the UCC clearly provides that a drawee bank is under "no obligation to certify a check." U.C.C. § 3-411(2) (1978). Nevertheless, under certain circumstances the drawee bank may be liable to the holder of a check. For example, the official comment to section 3-409(2) provides that a bank may be liable to a holder if it fails to accept a check although it had represented that it would do so, or if the bank fails to comply with the terms of a letter of credit. *Id.* § 3-409 official comment. In addition, where the issuance of a check clearly is an assignment of funds, the drawee bank may be liable to the holder for wrongfully dishonoring the check. 5A *BANKS AND BANKING*, *supra*, § 203, at 541. Three conditions must be satisfied in order for a check to qualify as an assignment: "(1) The check must be drawn on a specific fund; (2) there must be an agreement by the bank to pay certain checks with specific funds; and (3) the bank must have knowledge of and agree to the equitable assignment pro tanto of the fund." *Steinbrecher v. Fairfield County Trust Co.*, 5 Conn. Cir. Ct. 393, 401, 255 A.2d 138, 142 (1968); see also *In re Schenck's Estate*, 63 Misc. 2d 721, 724, 313 N.Y.S.2d 272, 280 (Sur. Ct. Suffolk County 1970) (check may be an assignment when parties so intend); *Banco Longoria, S.A. v. El Paso Nat'l Bank*, 415 S.W.2d 1, 5 (Tex. Civ. App. 1967) (parties may agree to make issuance of an instrument an assignment).

⁴ See *Barnett Bank v. Capital City First Nat'l Bank*, 348 So. 2d 643, 644 (Fla. Dist. Ct. App. 1977); *Morris Plan Co. v. Broadway Nat'l Bank*, 598 S.W.2d 557, 559 (Mo. Ct. App. 1980).

⁵ U.C.C. § 4-402 (1978). The UCC defines a customer as "any person having an account with a bank or for whom a bank has agreed to collect items [including] a bank carrying an account with another bank." *Id.* § 4-104(1)(e); see also *Marine Midland Bank, N.A. v. Price, Miller, Evan & Flowers*, 57 N.Y.2d 220, 225-26, 441 N.E.2d 1083, 1085-86, 455 N.Y.S.2d 565, 567-68 (1982) (person for whom bank agrees to accept checks and to wire transfer funds represented by the checks to another bank is bank's customer by the terms of the UCC).

⁶ See, e.g., *Conn v. Bank of Clarendon*, 53 Ill. 2d 33, 38, 289 N.E.2d 425, 428 (1972); *Galaxy Boat Mfg. Co. v. East End State Bank*, 641 S.W.2d 584, 586 (Tex. Civ. App. 1982).

⁷ The U.C.C. definition of the term "holder" will be used throughout this Article. Under the UCC, a "holder" is a person "in possession of . . . an instrument . . . drawn,

ment against the drawer and any indorsers of the instrument,⁸ and also may be able to recover from his transferor on the underlying obligation.⁹ Circumstances may arise, however, that leave the holder without an adequate remedy. For example, after the bank's refusal to pay the holder, the drawer may withdraw the funds and abscond.¹⁰ The holder simply may be unable to find a solvent party to the instrument,¹¹ or the payee may be a gift beneficiary, or the drawer may die shortly after the check is dishonored, or otherwise repudiate his promise.¹²

issued, or indorsed to him or to his order or to bearer or in blank." U.C.C. § 1-201(20) (1978).

⁸ *Id.* §§ 3-413(2), 3-414(1); see also *Stewart v. Citizens & S. Nat'l Bank*, 138 Ga. App. 209, 210-11, 225 S.E.2d 761, 762-63 (1976) (holder's remedy for dishonored check lies against drawer and indorsers rather than drawee bank). At common law, it was well established that an indorser, similar to a drawer, personally guarantees that the instrument will be paid. See *Bank of British N. Am. v. Ellis*, 2 Fed. Cas. 622, 623 (C.C.D. Or. 1879) (No. 859); *Johnson v. Crane*, 16 N.H. 68, 75 (1844); C. NORTON, *HANDBOOK OF THE LAW OF BILLS AND NOTES* § 78, at 218 (4th ed. 1914).

⁹ U.C.C. § 3-802(1)(b) (1978); see also *Mansion Carpets, Inc. v. Marinoff*, 24 App. Div. 2d 947, 947, 265 N.Y.S.2d 298, 299 (1st Dep't 1965) (action by payee for wrongful dishonor may be brought on instrument or on the underlying obligation); *Gaskins v. Duke*, 483 S.W.2d 499, 500 (Tex. Civ. App. 1972) (holder who takes check for consideration may maintain action against drawer either on the instrument or on the original obligation). The principle that the obligation survives delivery of the check and continues until the check is presented for payment was developed at common law, prior to the enactment of the Uniform Negotiable Instruments Law. See, e.g., *Segrist v. Crabtree*, 131 U.S. 287, 289 (1888) (citing *Sheehy v. Mandeville*, 10 U.S. (6 Cranch) 253, 264 (1810)) (note does not discharge original obligation except if parties expressly agreed to such); *Clark v. Young & Co.*, 5 U.S. (1 Cranch) 181, 182 (1803) (issuance of note for goods received is conditional payment and does not discharge debt); 3 J. DANIEL, *A TREATISE ON THE LAW OF NEGOTIABLE INSTRUMENTS* § 1448, at 1491 (7th ed. 1933) (bill of exchange or promissory note does not discharge debt absent agreement). Though this rule was not incorporated into any provision of the NIL, it apparently survived the enactment of the statute. See, e.g., *Hamilton v. R.S. Dickson & Co.*, 85 F.2d 107, 107-08 (2d Cir. 1936) (debt is not discharged by issuance of check but is only discharged when check is paid); *Huron College v. Union County Trust Co.*, 77 F.2d 609, 613 (8th Cir. 1935) (payee may sue maker of note on original obligation if payee accounts for instrument and maker is reasonably assured against threat of double payment, notwithstanding loss of instrument); *In re Wegman Piano Co.*, 221 F. 128, 131 (N.D.N.Y. 1915) (mere giving of note does not extinguish original claim or debt unless otherwise agreed).

¹⁰ See, e.g., *Go-Tane Serv. Stations, Inc. v. Sharp*, 78 Ill. App. 3d 785, 789-90, 397 N.E.2d 249, 249-51 (1979) (no cause of action lies against bank for dishonor when drawer withdraws all his funds and leaves the jurisdiction).

¹¹ See, e.g., *Yacht Club Sales & Serv., Inc. v. First Nat'l Bank*, 101 Idaho 852, 857, 623 P.2d 464, 469 (1980) (bank not liable for dishonoring check when drawer's account held under writ of execution).

¹² See U.C.C. § 3-408 (1978) ("[w]ant or failure of consideration is a defense as against any person not having the rights of a holder in due course"). Similarly, the drawer could die before the check is presented for payment or is certified, in which case the check would be revoked, leaving the holder with no cause of action against the drawer's estate, see *In re*

The purpose of this Article is to suggest that the holder of a check should be able to recover from a drawee bank that wrongfully dishonors the check. This is not a novel suggestion, as the liability of a drawee bank to a checkholder for wrongful dishonor was hotly debated prior to the enactment of the NIL.¹³ Discussion of the issue virtually ceased upon enactment of the NIL, as it was believed that the statute settled the question in favor of banks.¹⁴ While the relevant language of the UCC varies somewhat from that contained in the NIL, the UCC language is still generally interpreted as barring any action by the holder against the drawee bank, except in special circumstances. After examining the pre-Code law regarding a drawee bank's wrongful dishonor of a check, this Article will argue that there is no sound reason for insulating banks from liability, and will propose two legal theories, not precluded by the language of the Code, under which the holder of a check should be able to recover from a drawee bank that wrongfully dishonors a check.

PRE-NIL LAW

Prior to the enactment of the NIL, courts could not agree whether the holder of an uncertified check could sue a bank for refusal to honor the check even though sufficient funds were on hand. Indeed, as one writer observed, the question "divided the opinions of courts and jurists, and no little perplexed the legal profession."¹⁵ In this uncertain environment, holders invoked, with

Ludlum's Estate, 158 Misc. 283, 284-85, 285 N.Y.S. 597, 600 (Sur. Ct. N.Y. County 1936); 3 J. DANIEL, *supra* note 9, § 1817, at 1855, or the drawer may stop payment and repudiate the underlying obligation without incurring liability, *see, e.g.*, *Hardeman v. State*, 154 Ga. App. 364, 365, 268 S.E.2d 415, 417 (1980); *see also* *Ampex Corp. v. Appel Media, Inc.*, 374 F. Supp. 1114, 1116 (W.D. Pa. 1974) (under the Code, drawer may raise defense of lack of consideration against one who has not paid value); *Smith v. Gentilotti*, 371 Mass. 839, 841, 359 N.E.2d 953, 955 (1977) (since donee is not a holder in due course, his claim is subject to the defense of lack of consideration).

¹³ *See infra* notes 15-56 and accompanying text.

¹⁴ *See Eastman Kodak Co. v. National Park Bank*, 231 F. 320, 322 (S.D.N.Y. 1916) (NIL eliminated need to prove that check was not an assignment), *aff'd*, 247 F. 1002 (2d Cir. 1917); *Superior Nat'l Bank v. National Bank of Commerce*, 99 Neb. 833, 836, 157 N.W. 1023, 1024 (1916) (NIL clearly provides that bank is not liable on check until it has accepted the check); F. BEUTEL, *BEUTEL'S BRANNAN NEGOTIABLE INSTRUMENTS LAW* § 189, at 1325 (7th ed. 1948) (holder has no cause of action under NIL against drawee bank if bank states that the check will be paid upon presentment).

¹⁵ 3 J. DANIEL, *supra* note 9, § 1836, at 1879. *Compare* *Munn v. Burch*, 25 Ill. 21, 26 (1860) (drawee becomes holder of funds for payee upon presentment and thus must account to payee for such funds) *and* *Fonner v. Smith*, 31 Neb. 107, 109, 47 N.W. 632, 633 (1891)

some success, various legal theories in seeking to recover from payor banks for wrongful dishonor.

Assignment

In a number of cases brought prior to the enactment of the NIL, the holder argued that a depositor, by drawing a check on a bank account that had adequate funds to cover it, actually had transferred the sum named on the check to the payee; therefore, the payee could sue for and recover that sum from the bank if it refused to pay upon presentment.¹⁶ Most courts rejected this argument. The majority of courts treated a check as if it were an ordinary bill of exchange¹⁷ and, upon finding that the money deposited in the bank became a part of the bank's general assets, viewed the relationship between a drawer and a drawee as a creditor-debtor relationship.¹⁸ These courts thus held that the general rule forbidding a party's contractual responsibilities to be varied from those contained in the original contract in a manner that would subject him to the demands of several persons precluded recognition of such an "assignment" in the absence of acceptance by the debtor drawee.¹⁹ There was also concern that the bank would be obliged

(holder recovered bank funds from drawee bank on check assignment theory) *with* Bank of the Republic v. Millard, 77 U.S. (10 Wall.) 152, 158 (1869) (deposited money is bank's property and bank is not obligated to holder) *and* Marine Bank v. Fulton Bank, 69 U.S. (2 Wall.) 252, 258 (1864) (customer established debtor-creditor relationship with bank, therefore, check not an assignment).

¹⁶ See, e.g., Laclede Bank v. Schuler, 120 U.S. 511, 512 (1887) (plaintiff claimed check was an assignment on an appropriation of funds for his benefit); Roberts v. Austin Corbin & Co., 26 Iowa 315, 325-26 (1868) (holder permitted to maintain action against drawee provided the drawer has adequate funds, since drawer's promise to pay the payee accrues when check is delivered); see also Munn v. Burch, 25 Ill. 21, 26 (1860) (holder argued successfully that check served to transfer title to funds in drawer's account to payee); Fogarties v. State Bank, 46 S.C.L. (12 Rich.) 518, 525 (1860) (since presentment creates contract between drawee and payee, payee has cause of action in case of wrongful dishonor).

¹⁷ See, e.g., Rogers v. Durant, 140 U.S. 298, 302-03 (1890); Moses v. Franklin Bank, 34 Md. 574, 579-80 (1871); see C. NORTON, *supra* note 8, § 152, at 586; 3 J. POMEROY, EQUITY JURISPRUDENCE § 1284, at 3089 (4th ed. 1918).

¹⁸ See, e.g., Bank of the Republic v. Millard, 77 U.S. (10 Wall.) 152, 155-57 (1869) (bank is debtor of depositor customer); Chapman v. White, 6 N.Y. 412, 416-17 (1852) (deposited money becomes property of debtor-bank); Covert v. Rhodes, 48 Ohio St. 66, 68, 27 N.E. 94, 95 (1891) (bank's obligation on check is not as trustee but as debtor).

¹⁹ See, e.g., Bank of the Republic v. Millard, 77 U.S. (10 Wall.) 152, 156 (1869) (absence of privity between holder and drawee makes action by holder for wrongful dishonor untenable); Cincinnati, H. & D.R.R. v. Metropolitan Nat'l Bank, 54 Ohio St. 60, 72, 42 N.E. 700, 702-03 (1896) (since bank's contractual agreement is with depositor, no duty to payee results from the drafting of a check). The application of the general rule to cases involving wrongful

to pay the check, even though the drawer had countermanded it before it was presented and although other checks, drawn after it was issued but before payment was demanded, had exhausted the funds of the depositor.²⁰

Other courts, however, permitted a holder to recover from the drawee bank, relying to some extent on an assignment theory.²¹ In *Munn v. Burch*,²² a leading case supporting this view, the Illinois Supreme Court held:

[T]he check of a depositor upon his banker, delivered to another for value, transfers to that other, the title to so much of the deposit as the check calls for . . . and *when presented to the banker*, [the banker] becomes the holder of the money to the use of the owner of the check, and is bound to account to him for that amount, provided the party drawing the check has funds to that amount on deposit, subject to his check at the time it is presented.²³

Several commentators agreed with the *Munn* holding that, once presentment to the bank had been made, the holder could claim that an appropriation of funds had occurred.²⁴ As one writer explained:

It is true . . . that before demand for payment no assignment exists, no obligation has been created, no privity has grown up, and

dishonor to prevent drawees from being subjected to two claims arising from the same transaction has been criticized as illogical and unwarranted. See 2 J. MORSE, TREATISE ON THE LAW OF BANKS AND BANKING § 507, at 1128 (6th ed. 1928).

²⁰ *Bank of the Republic v. Millard*, 77 U.S. (10 Wall.) 152, 156 (1869); *accord* *Satterwhite v. Melczer*, 3 Ariz. 162, 167, 24 P. 184, 185 (1890) (bank not liable to payee, particularly in situations where it is unclear which of two payees has paramount right to funds); *Pullen v. Placer County Bank*, 138 Cal. 169, 172-73, 71 P. 83, 84 (1902) (liability to payee would place risks of countermand or insufficient funds on drawee bank).

²¹ See, e.g., *Bank of Antigo v. Union Trust Co.*, 149 Ill. 343, 351-52, 36 N.E. 1029, 1031 (1894); *National Bank of Am. v. Indiana Banking Co.*, 114 Ill. 483, 491-92, 2 N.E. 401, 404-05 (1885); *Fonner v. Smith*, 31 Neb. 107, 111, 47 N.W. 632, 632-33 (1891).

²² 25 Ill. 21 (1860). The plaintiff in *Munn* accepted a check drawn by a third party on Burch & Company, the defendant bank, in partial payment for a large quantity of wheat. *Id.* at 22. The plaintiff deposited the check in his bank, and the bank presented it to Burch for payment. *Id.* The check was accepted, since sufficient funds were on deposit at the time it was presented. *Id.* Burch & Company, however, paid other outstanding checks written on the account first, depleting the account to the extent that the first check was returned to the plaintiff unpaid. *Id.* A suit was instituted against the drawee bank to compel payment on the theory that the check operated as an assignment of the drawer's funds on deposit at the time of presentment. *Id.*

²³ *Id.* at 26 (emphasis added).

²⁴ See, e.g., 3 J. DANIEL, *supra* note 9, § 1843, at 1888; 2 J. MORSE, *supra* note 19, § 494, at 112-13.

the very right of the bank to pay may be taken away by any one of a great number of occurrences. But the act of presentment and demand, made before any one of these occurrences has taken place, is the act which creates at once, by usage of business and understanding of all concerned, the obligation, the privity, and the appropriation, or at least the right to claim an appropriation.²⁵

Several courts found that the general rule prohibiting the assignment of a portion of the debt had no applicability to the situation where a bank is the drawee-debtor.²⁶ Those courts recognized that, by custom and by contract, the bank had agreed to pay the funds to as many different people and in as many different portions as the customer should order by his written check.²⁷ This was distinguishable from the "ordinary" bill of exchange, in which the debtor has agreed to pay only one person.²⁸

Implied Promise/Third Party Beneficiary

Checkholders seeking to recover from drawee banks also argued that when the depositor deposited funds in his bank, an implied promise or agreement between the depositor and the bank was made that benefited the checkholder.²⁹ There was, however, vigorous opposition to imposing any "implied duty" to checkholders upon banks.³⁰ A number of courts were particularly concerned with the lack of privity between the holder and the

²⁵ J. MORSE, *supra* note 19, at 471 (1st ed. 1870).

²⁶ See, e.g., *Bank of Antigo v. Union Trust Co.*, 149 Ill. 343, 352, 36 N.E. 1029, 1031 (1894) (bank deposit exception widely affirmed by Illinois courts); *Munn v. Burch*, 25 Ill. 21, 24 (1860) (bank deposits are an exception to general rule prohibiting assignment of portions of debt); *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 324-25 (1868) (merchants', bankers', and farmers' expectations of receiving payment on presentment have spawned the evolution of the bank deposits exception).

²⁷ See, e.g., *Bank of Antigo v. Union Trust Co.*, 149 Ill. 343, 352, 36 N.E. 1029, 1031 (1894); *Munn v. Burch*, 25 Ill. 21, 24 (1860); *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 324-25 (1868).

²⁸ 3 J. POMEROY, *supra* note 17, § 1284, at 3089-91 (jurisdictions holding that checks are assignments of funds have distinguished checks from bills of exchange); see *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 326 (1868) ("[t]his doctrine that the payee or holder may have his action against the drawee, is limited to cases of *checks*, and has no application . . . to bills of exchange") (emphasis in original).

²⁹ See *infra* note 35 and accompanying text.

³⁰ See, e.g., *Grammal v. Carmer*, 55 Mich. 201, 203, 21 N.W. 418, 420 (1884); *Aetna Nat'l Bank v. Fourth Nat'l Bank*, 46 N.Y. 82, 86 (1871); *Commercial Nat'l Bank v. First Nat'l Bank*, 118 N.C. 783, 787, 24 S.E. 524, 524 (1896); *The Liability of a Bank to the Holder of a Check*, Alb. L.J., July 26, 1873, at 50.

bank.³¹ For example, the United States Supreme Court in *Bank of the Republic v. Millard*³² observed:

On principle, there can be no foundation for an action on the part of the holder, unless there is a privity of contract between him and the bank. How can there be a privity when the bank owes no duty and is under no obligation to the holder? The holder takes the check on the credit of the drawer in the belief that he has the funds to meet it, but in no sense can the bank be said to be connected with the transaction.³³

The *Millard* Court also was concerned that, since the drawer could maintain an action for breach of contract, if the holder of the check also were allowed to sue, then there could arise the anomalous situation of "a right of action upon one promise, for the same thing, existing in two distinct persons, at the same time."³⁴

Many courts also rejected the argument that the holder was a third party beneficiary, noting that in cases where a third party beneficiary theory had been applied, either the third party was designated at the time the contract was entered into, or an appropriation of the funds for that party's benefit was made at the time of the contract.³⁵ The courts were unwilling to find that an obligation as to amounts not specified or presently ascertainable would attach in favor of future creditors who were unnamed and unknown.³⁶

³¹ See, e.g., *Laclede Bank v. Schuler*, 120 U.S. 511, 514 (1887); *First Nat'l Bank v. Whitman*, 94 U.S. 343, 344-45 (1876); *Nat'l Bank of New Jersey v. Berrall*, 70 N.J.L. 757, 759-60, 58 A. 189, 190 (1904).

³² 77 U.S. (10 Wall.) 152 (1869). In *Millard*, a creditor of the United States was given a check drawn on the Bank of the Republic. *Id.* The check was honored by the bank on a forged indorsement. *Id.* Upon proof of the forgery and recovery of the check, the creditor represented the check to the bank. *Id.* at 153. The bank refused to make payment, notwithstanding that it had sufficient funds on hand to cover the check. *Id.*

³³ *Id.* at 156.

³⁴ *Id.*; accord *Carr v. National Sec. Bank*, 107 Mass. 45, 49 (1871) (bank's promise to honor checks of drawer does not render it liable to holder while still obligated to account to drawer for funds paid); *Aetna Nat'l Bank v. Fourth Nat'l Bank*, 46 N.Y. 82, 86 (1871) (to impose liability on bank for breach of deposit contract to both holder and drawer would create anomaly in the law).

³⁵ See, e.g., *Fourth St. Bank v. Yardley*, 165 U.S. 634, 644 (1897) (if check is to be paid out of specified fund, drawee with notice of this fact is liable to holder); *Ballard v. Home Nat'l Bank*, 91 Kan. 91, 96, 136 P. 935, 936 (1913) (contract with bank that obviously is for holders' benefit creates a right of action in holder against bank); *People's Nat'l Bank v. Swift*, 134 Tenn. 175, 182, 183 S.W. 725, 727 (1916) (traditional rule not applicable when parties arrange for appropriation of fund and inform bank of the arrangement).

³⁶ See, e.g., *Harrison v. Wright*, 100 Ind. 515, 538-39 (1884); *Cincinnati, H. & D. R.R. v.*

A number of courts, however, did permit recovery under an "implied promise" theory.³⁷ One writer explained:

[I]t is the universal understanding between banks and depositors, arising from the customs of trade, that the check of the latter is to be paid upon presentment. . . . The drawer of the check makes the deposit, and draws the check with this understanding. The bank receives the money with the like understanding, and so the holder receives the check. And the mutual understanding of the parties, although they have not individually concerted together, creates an implied privity, and completes the contract between them.³⁸

Indeed, the Illinois court, in *Munn v. Burch*,³⁹ forcefully stated that the banker agrees with "the whole world" that whoever becomes a holder would, upon presentation, be entitled to recover on the check, so long as the drawer had sufficient funds on deposit.⁴⁰ Courts adopting the implied promise theory rejected the lack of privity argument, relying on the general principle that where one person makes a promise to another for the benefit of a third, the latter may maintain an action on it, though the consideration did not move from him.⁴¹ These courts were not concerned that the particular beneficiary was unknown to the promisor bank at the time of the promise, since "privity" was created when the checkholder presented the check for payment, and it was only at

Metropolitan Nat'l Bank, 54 Ohio St. 60, 69-70, 42 N.E. 700, 702-03 (1896).

³⁷ See, e.g., *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 325-26 (1868) (holder can maintain action based on implied promise of party receiving deposits to pay them out on receipt of depositor's checks); *Fonner v. Smith*, 31 Neb. 107, 110, 47 N.W. 632, 632 (1891) (when bank receives deposits it impliedly promises to pay depositor's checks to presenters); *Fogarties v. State Bank*, 46 S.C.L. (12 Rich.) 518, 530 (1860) (accepting money and promising to disburse it as ordered creates contract that puts bank in privity with the party to whom bank is ordered to make payment); *Turner v. Hot Springs Nat'l Bank*, 18 S.D. 498, 502, 101 N.W. 348, 349 (1904) (acceptance of most checks that pass in commerce based on implied promise to pay promptly such amounts as depositor orders).

³⁸ 3 J. DANIEL, *supra* note 9, § 1841, at 1885-86.

³⁹ 25 Ill. 21 (1860).

⁴⁰ *Id.* at 24-25; accord *May v. Jones*, 87 Iowa 188, 197-98, 54 N.W. 231, 234 (1893) (delivery and intent give rise to right to enforce vesting of implied right in payee); *Senter v. Continental Bank*, 7 Mo. App. 532, 534 (1877) (commercial necessities dictate need for implied right vesting in payee).

⁴¹ See, e.g., *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 324-26 (1868) (delivery of bank check carries with it a right of action against drawee bank); *Fonner v. Smith*, 31 Neb. 107, 111, 47 N.W. 632, 633 (1891) (party may sue on promise made to another for sufficient consideration if it was made for party's use and benefit); *Turner v. Hot Springs Nat'l Bank*, 18 S.D. 498, 500, 101 N.W. 348, 350 (1904) (bank agrees that holder of check has right to receive amount to which it is drawn if drawer has such amount on deposit).

that point that the holder could sue the bank that wrongfully refused to honor the check.⁴²

Finally, courts utilizing the implied promise theory recognized that parties are often liable to more than one person for a single wrongful act, and the fact that the bank may be liable to its depositor should not except the bank from performing its promise to the checkholders.⁴³ These courts suggested that no problems would be created by permitting a checkholder to recover on the instrument while permitting the depositor to recover nominal or special damages for the breach.⁴⁴

Pre-NIL Analysis

The failure of some courts to distinguish between a check and an ordinary bill of exchange resulted in this split of authority in the courts.⁴⁵ The original bill of exchange was probably a letter of credit from a merchant to his debtor, a merchant in another country, asking the debtor to pay the debt to a third person, who carried the letter and who happened to be travelling to where the debtor resided.⁴⁶ It was a convenient, inexpensive, and relatively risk-free means of making payment. The holder of a bill sometimes presented the bill to the party to whom it was addressed in order to ascertain in advance whether the bill would be paid. This promise to pay was the origin of acceptance.⁴⁷ Once accepted by the debtor, the value of the debt was reduced to a certain amount, and evidence of the original demand was unnecessary, since the bill af-

⁴² See, e.g., *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 324-25 (1868); *Fonner v. Smith*, 31 Neb. 107, 111, 47 N.W. 632, 633 (1891); *Turner v. Hot Springs Nat'l Bank*, 18 S.D. 498, 503-04, 101 N.W. 348, 350 (1904).

⁴³ See, e.g., *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 325 (1868); *Turner v. Hot Springs Nat'l Bank*, 18 S.D. 498, 500, 101 N.W. 348, 349-50 (1904).

⁴⁴ See, e.g., *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 325 (1868).

⁴⁵ Compare *First Nat'l Bank v. Whitman*, 94 U.S. 343, 345 (1876) (no right of action for checkholder since checks are treated like bills of exchange for purposes of determining payee's rights) and *Moses v. President & Directors of the Franklin Bank*, 34 Md. 575, 580-82 (1871) (check, like a bill of exchange, need not be accepted by bank upon presentment) with *Munn v. Burch*, 25 Ill. 21, 24 (1860) (check differs from typical creditor's order to pay third party since, by longstanding custom, "they are received, and passed and deposited with bankers as cash").

⁴⁶ W. WARD & H. HARFIELD, *BANK CREDITS AND ACCEPTANCES* 9 (4th ed. 1958).

⁴⁷ See *Van Buskirk v. State Bank*, 35 Colo. 142, 146, 83 P. 778, 779 (1905). For a discussion of the nature of acceptance regarding bills of exchange, see 2 J. DANIEL, *supra* note 9, § 541, at 604-05.

forded a clear title to the debt.⁴⁸

In considering this type of bill of exchange, it was logical to conclude that the drawee was not liable to the holder prior to acceptance. Though the drawee and drawer had a debtor-creditor relationship, the payee of the bill had no relationship with the drawee.⁴⁹ Indeed, the drawee had never promised, expressly or implicitly, to pay the debt owed to the drawer to any third parties. Courts, therefore, were understandably unwilling to permit the drawer to divide up his demand against the debtor drawee and require the latter to pay it in parcels without the drawee's consent. Once the drawee accepted the bill of exchange, however, the consent was given⁵⁰ and courts could find that "privity" had been established between the payee and the drawee, enabling the payee to sue a drawee that failed to pay the bill.⁵¹ Conversely, without acceptance, and in the absence of special circumstances indicating that an assignment had been made, the drawee could refuse to pay.⁵² This meant that the payee's only recourse was against the drawer, the party primarily liable on the bill.⁵³

The better-reasoned cases recognized that a check is not an ordinary bill of exchange.⁵⁴ Though a debtor-creditor relationship

⁴⁸ 1 J. DANIEL, *supra* note 9, § 2, at 3.

⁴⁹ *Deen v. De Soto Nat'l Bank*, 97 Fla. 862, 866, 122 So. 105, 106 (1929) (absent acceptance of bill of exchange, drawee enters into no contractual relations with payee in respect to it); *Gammel v. Carmer*, 55 Mich. 201, 205, 21 N.W. 418, 420 (1884) (until drawee is presented with and accepts bill of exchange, he has no contractual relationship with payee).

⁵⁰ *Cox v. National Bank*, 100 U.S. 704, 712 (1879); *Swope v. Ross*, 40 Pa. 186, 188 (1881).

⁵¹ *See, e.g., Hoffman & Co. v. Bank of Milwaukee*, 79 U.S. (12 Wall.) 181, 192 (1870) (acceptance imparts an obligation on the part of the acceptor to pay a payee who has paid value for the bill accepted); *see C. NORTON, supra* note 8, § 69, at 196; J. STORY, *COMMENTARIES ON THE LAW OF BILLS AND EXCHANGE* 131-32 (1843).

⁵² *See, e.g., Gammel v. Carmer*, 55 Mich. 201, 205 (1884); *Clements v. Yeates*, 69 Mo. 624, 625 (1879); *Kimball v. Donald*, 20 Mo. 577, 582 (1855).

⁵³ *See, e.g., Watson v. Tarpley*, 59 U.S. (18 How.) 517, 519 (1855) (upon presentment of bill and drawee's subsequent refusal to accept, payee has right to immediate recourse against drawer); *Wood v. McMeans*, 23 Tex. 481, 484 (1859) (where drawee refused to accept draft, drawer immediately rendered liable). Since the payee has no right of action against the drawee in the absence of his acceptance of the instrument, *see Bull v. Bank of Kasson*, 123 U.S. 105, 111 (1887), the only recourse for the payee would be an action against the drawer.

⁵⁴ *See, e.g., Munn v. Burch*, 25 Ill. 21, 24-25 (1860) (by custom, check is treated as equivalent to cash because its issuance is based on bank's implied contract with depositor to pay funds on deposit to holders); *Roberts v. Austin Corbin & Co.*, 26 Iowa 315, 325-26 (1868) (doctrine that implied contract between bank and its depositor permits payee recovery does not apply to bills of exchange).

exists between the drawee bank and its drawer-customer, there is also a contractual relationship between the parties. In return for the use of the drawer's funds, the bank agrees to allow the drawer to write checks in such sums as he sees fit to numerous third parties who are unknown at the time the account is created.⁵⁵ Thus, the rule that a party could not assign a portion of the debt owed would not seem to be applicable when the debtor is a bank. Nor could a bank argue that its original contract was being varied or that it should not be held liable to unknown future creditors for unspecified amounts. In light of the foregoing, it is not surprising that the majority of textbook writers who addressed this issue prior to the NIL agreed that a checkholder should be able to sue a bank for improperly dishonoring the check.⁵⁶

THE UNIFORM NEGOTIABLE INSTRUMENTS LAW

Two sections of the NIL generally resolved this split in the jurisdictions. Section 127 provided:

A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.⁵⁷

Similarly, section 189, which dealt specifically with checks, provided:

A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check.⁵⁸

These provisions rejected the argument that a check standing

⁵⁵ B. CLARK & A. SQUILLANTE, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* 28 (1970). Clark states that "[t]he relationship between the drawee bank and its customer as drawer of a check is primarily based on the deposit contract. The demand deposit account creates a debtor-creditor relationship The demand account gives the customer the right to order his bank to pay checks so long as funds are available" *Id.* He does not, however, acknowledge that the holder has a legal right to sue the drawee on the basis of the contract. *Id.* at 57. *But see Note, The Holder of a Check as a Beneficiary of a Third Party Beneficiary Contract*, 26 COLUM. L. REV. 459, 459-64 (1926) (payee should be treated as third party beneficiary of the deposit contract).

⁵⁶ See, e.g., 3 J. DANIEL, *supra* note 9, §§ 1837-1842; see H. VAN SCHAAK, *THE LAW OF BANK CHECKS IN THE UNITED STATES* 214 (2d ed. 1892).

⁵⁷ UNIF. NEGOTIABLE INSTRUMENTS LAW § 127 (1896) (superceded 1952).

⁵⁸ *Id.* § 189.

alone could operate as an assignment. Moreover, while section 127 governing bills of exchange provided that until acceptance the drawee was "not liable on the bill," section 189, dealing with checks, contained more sweeping language, providing that until acceptance the bank was "not liable to the holder."⁵⁹ As a result, cases that had previously permitted holders to proceed on an assignment or implied contract theory were generally overruled.⁶⁰

Finding their contract actions barred by the NIL, holders in a number of cases based their actions against the drawee in tort, arguing that section 189 was inapplicable to tort claims. Such actions for "negligence," "conversion," or "malicious interference with business transactions" failed, because courts concluded that, without privity, the banks owed no legal duty to the checkholders.⁶¹ Courts described the actions as "illogical,"⁶² or as "thinly veiled attempts to thwart the intended effect of [the] statute."⁶³ In rejecting the contention that the drawee's refusal to honor a check might constitute a tortious interference with a business transaction, one court explained:

Were this cause of action in tort allowed to proceed in spite of this statute the effect would be to completely negate the purpose and effect of this statute. It is readily apparent that any refusal to honor a check by a bank, precisely the activity authorized by this statute, . . . could also be said to constitute an interference with business relations.⁶⁴

Moreover, while one court has suggested that a holder might be able to recover from a bank that had refused payment intentionally in order to defraud the holder,⁶⁵ other courts have indi-

⁵⁹ See Aigler, *supra* note 1, at 869-70, 884.

⁶⁰ See Leach v. Mechanics' Sav. Bank, 202 Iowa 899, 905, 211 N.W. 506, 508 (1926); First Nat'l Bank v. Hargis Commercial Bank & Trust Co., 170 Ky. 690, 693, 186 S.W. 471, 472 (1916).

⁶¹ See, e.g., Elmore v. Palmer First Nat'l Bank & Trust Co., 221 So. 2d 164, 167 (Fla. Dist. Ct. App. 1969); First Nat'l Bank v. Hargis Commercial Bank & Trust Co., 170 Ky. 690, 693, 186 S.W. 471, 472 (1916); see also General Am. Life Ins. Co. v. Stadiem, 223 N.C. 49, 53, 25 S.E.2d 202, 205 (1943) (claim for wrongful and negligent failure to pay check dismissed on ground that no action at law was available, since bank was not liable to holder until it accepted check).

⁶² First Nat'l Bank v. Hargis Commercial Bank & Trust Co., 170 Ky. 690, 693, 186 S.W. 471, 472 (1916).

⁶³ Elmore v. Palmer First Nat'l Bank & Trust Co., 221 So. 2d 164, 166 (Fla. Dist. Ct. App. 1969).

⁶⁴ *Id.* at 167.

⁶⁵ Berkoff v. Klein, 81 N.Y.S.2d 244, 245 (Sup. Ct. Kings County 1948) (dictum). The

cated that a bank's reason for wrongfully dishonoring the check simply made no difference to the outcome of the action.⁶⁶ For example, in a case in which a holder alleged that a bank's wrongful refusal to pay a check was based upon a mistake of fact,⁶⁷ Judge Learned Hand stated:

The mistake was quite irrelevant. Had the . . . [b]ank refused to honor the check willfully and for no reason whatever, no liability would have attached to it; the payee can sue only the drawer, and the drawer must look to the drawee.⁶⁸

It is doubtful that section 189 was intended to cover completely the subject of the liability of a bank to the holder of a check for wrongful dishonor.⁶⁹ The provision that "the bank is not liable to the holder" immediately followed the declaration that "a check of itself does not operate as an assignment."⁷⁰ Thus, while the section made clear that a bank normally was not liable to a holder *as an assignee*,⁷¹ it was not so clear that liability under some other theory was prohibited.⁷² However, in view of the expansive language contained in section 189, as compared to section 127, it is not surprising that section 189 was interpreted as a broad prohibition.⁷³ A typical interpretation of these sections is illustrated

Berkoff court observed: "if the bank intentionally refused payment because there were insufficient funds in the bank . . . that would be deception, an unlawful act, and if it contained all of the elements of fraud, it could be the basis of a scheme to defraud the plaintiff." *Id.*

⁶⁶ See, e.g., *South Carolina Nat'l Bank v. McCandless*, 44 F.2d 111, 113 (4th Cir. 1930); *Sneider v. Bank of Italy*, 184 Cal. 595, 599, 194 P. 1021, 1023 (1920); *Columbia-Knickerbocker Trust Co. v. Miller*, 215 N.Y. 191, 196, 109 N.E. 179, 180 (1915).

⁶⁷ *Eastman Kodak Co. v. National Park Bank*, 231 F. 320, 325 (S.D.N.Y. 1916), *aff'd*, 247 F. 1002 (2d Cir. 1917). In *Eastman Kodak*, a check had been recorded on the books of the drawee bank, but had gone unpaid by mistake. 231 F. at 322. When the check was presented again on the following day, the drawee bank refused to honor it since the bank mistakenly believed it had received no instructions to pay. *Id.*

⁶⁸ *Id.* at 325.

⁶⁹ See *State v. First Nat'l Bank*, 38 N.M. 225, 232, 30 P.2d 728, 732 (1934) ("nothing in the Negotiable Instruments Law would deny [payee the] right" to recover for conversion of funds); Aigler, *supra* note 1, at 884 (NIL only was intended to establish that drawee bank was not to be considered liable to holder as assignee based upon existence of check alone). But see *Elyria Sav. & Banking Co. v. Walker Bin Co.*, 92 Ohio St. 406, 414, 111 N.E. 147, 149 (1915) (section 189 "intended to cover the liability of a bank to the holder of a check").

⁷⁰ UNIF. NEGOTIABLE INSTRUMENTS LAW § 189 (1896) (superceded 1952); see Aigler, *supra* note 1, at 883-84.

⁷¹ Aigler, *supra* note 1, at 884.

⁷² See Note, *supra* note 55, at 464 (NIL does not appear "to unduly restrict third party beneficiary theory" which would permit payee recovery).

⁷³ Aigler, *supra* note 1, at 884.

by the following observation by one commentator:

the fact remains . . . that when the situation regarding bills of exchange generally was being provided for the language chosen was—"and the drawee is not liable *on the bill* unless and until he accepts the same." . . . Under . . . section [127] a drawee might well be held upon a tort liability. If the framers of the act did not intend a difference in result under the two sections, why did they use strikingly varying language?⁷⁴

Moreover, apart from the statute, there were problems with both the third party beneficiary and tort theories of recovery. While it had become well-settled that a beneficiary need not be ascertained at the time the promise was made,⁷⁵ and that the amount need not be certain at that time,⁷⁶ other problems with viewing a holder as a third party beneficiary persisted. There was concern that a bank pays checks in the order presented, not drawn, without inquiry into whether more checks have been drawn than there are funds available to pay them.⁷⁷ In addition, a bank is subject to its customer's stop payment order until the check is presented and paid or accepted. While it was suggested that these incidents could be incorporated into the bank's promise in the form of a condition precedent to recovery on that promise without negating the idea of a third party contract,⁷⁸ Williston observed that "[t]hese considerations largely explain the reluctance of the majority of jurisdictions to regard the payee or holder of a check as a third party beneficiary."⁷⁹

Regarding recovery based on tort theory, the notion that there could be no liability on the part of a contracting party to one with whom he was not in "privity" was firmly entrenched in this country.⁸⁰ Indeed, Justice Cardozo's landmark opinion of *MacPherson*

⁷⁴ See *id.* at 884 n.96 (citations omitted) (emphasis in original).

⁷⁵ See, e.g., *Ohio Casualty Ins. Co. v. Beckwith*, 74 F.2d 75, 78 (5th Cir. 1935); *Whitehead v. Burgess*, 61 N.J.L. 75, 77, 38 A. 802, 802 (1897); Note, *supra* note 55, at 460.

⁷⁶ See Note, *supra* note 55, at 460.

⁷⁷ 2 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 389, at 1054 (3d ed. 1959).

⁷⁸ See, e.g., Note, *supra* note 55, at 460.

⁷⁹ 2 S. WILLISTON, *supra* note 77, § 389, at 1054-55.

⁸⁰ See, e.g., *Birmingham Chero-Cola Bottling Co. v. Clark*, 205 Ala. 678, 680, 89 So. 64, 65 (1921); *Tompkins v. Quaker Oats Co.*, 239 Mass. 147, 149, 131 N.E. 456, 456 (1921); *Windram Mfg. Co. v. Boston Blacking Co.*, 239 Mass. 123, 124-25, 131 N.E. 454, 455 (1921); *Burkett v. Studebaker Bros. Mfg.*, 126 Tenn. 467, 472, 150 S.W. 421, 422 (1912).

The concept of privity had its origins in the 19th-century English case of *Winterbottom v. Wright*, 152 Eng. Rep. 402 (1842). In *Winterbottom*, the defendant was a manufacturer of mail coaches, and had sold a coach to the Postmaster-General. *Id.* The plaintiff, an em-

*v. Buick Co.*⁸¹ was not decided until 1916.⁸² Since *MacPherson*, significant inroads have been made in recognizing the rights of parties injured by the negligence of others with whom there is no privity.⁸³ It certainly is not surprising, however, that courts in the early 1900's could find no "legal duty" owed by the bank to a checkholder when no contractual relationship existed between them.

THE UNIFORM COMMERCIAL CODE

A checkholder seeking to recover from a drawee bank for its refusal to pay a check may run into several obstacles under various provisions of the Code. Section 4-402 provides that "[a] payor bank is liable to its *customer* for damages proximately caused by the wrongful dishonor of an item."⁸⁴ Relying upon this provision, several courts have concluded that the *only* party having a cause of action for wrongful dishonor under the UCC is the customer of the drawee bank.⁸⁵ Since a payee is not generally a "customer,"⁸⁶ courts have held that he has no action against the bank.⁸⁷ In addition, section 3-401(1) states that "[n]o person is liable on an in-

ployee of the Postmaster, was injured when thrown from the coach as the result of an accident caused by a latent defect in one of the wheels. *Id.* at 403. In holding for the defendant, Lord Abinger declared that unless liability on such contracts is confined "to the parties who entered into them, the most absurd and outrageous consequences, to which [there is] no limit, would ensue." *Id.* at 405. The rule enunciated in *Winterbottom* was, for the most part, adopted by American courts, and was applied in most cases, with the exception of those where liability resulted from the manufacture of inherently dangerous goods, *see, e.g.,* *Tompkins v. Quaker Oats Co.*, 239 Mass. 147, 149, 131 N.E. 456, 457 (1921), or from fraud, *see, e.g.,* *Burkett v. Studebaker Bros. Mfg.*, 126 Tenn. 467, 472, 150 S.W. 421, 422 (1912).

⁸¹ 217 N.Y. 382, 111 N.E. 1050 (1916).

⁸² *Id.* The *MacPherson* rule permitted persons to recover from the manufacturer, "irrespective of privity," for injuries suffered from defects resulting from the use of a product of a kind reasonably certain to be dangerous if negligently made. *Id.* at 389, 111 N.E. at 1053. The Court thus went beyond the narrow limits of the privity doctrine, under which third parties were permitted to recover only when the product or act in question is an element of destruction in its normal use or operation. *Id.*

⁸³ *See infra* text accompanying notes 151-87.

⁸⁴ U.C.C. § 4-402 (1978) (emphasis added).

⁸⁵ *See, e.g.,* *Bon Bon Prods., Ltd. v. Xanadu Prods., Inc.*, 32 U.C.C. Rep. Serv. (Callaghan) 253, 257 (D. Mass. 1981); *Steinbrecher v. Fairfield County Trust Co.*, 5 Conn. Cir. Ct. 393, 395, 255 A.2d 138, 139 (1968).

⁸⁶ *See* *Steinbrecher v. Fairfield County Trust Co.*, 5 Conn. Cir. Ct. 393, 395, 255 A.2d 138, 139 (1968) (customer defined as depositor, not as payee). For a discussion of the term "customer" under the UCC, *see supra* note 5.

⁸⁷ *See, e.g.,* *Southeastern Pipeline Serv., Inc. v. Citizens & S. Bank*, 617 F.2d 67, 69 (5th Cir. 1980); *Bon Bon Prods. v. Xanadu Prods.*, 32 U.C.C. Rep. Serv. (Callaghan) 253, 257 (D. Mass. 1981); *see also* H. BAILEY, *BRADY ON BANK CHECKS* § 18.8-9 (5th ed. Supp. 1983).

strument unless his signature appears thereon."⁸⁸ Thus, it has been held that a drawee cannot be liable on the instrument unless he accepts it.⁸⁹

Other courts have relied on section 3-409 of the Code to deny a checkholder any cause of action for the drawee bank's refusal to pay the check. Section 3-409, a revised version of section 189 of the NIL, provides:

- (1) A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it.
- (2) Nothing in this section shall affect any liability in contract, tort or otherwise arising from any letter of credit or other obligation or representation which is not an acceptance.⁹⁰

Citing this provision, courts have concluded that, prior to acceptance, the bank has no legal obligation to honor the check.⁹¹ For example, in *Stewart v. Citizens & Southern National Bank*,⁹² the holder of a check properly presented the check to the drawee bank's branch manager, who flatly refused to cash the check, even though he stated that there were sufficient funds in the drawee's account.⁹³ The checkholder sued the bank and its branch manager for their refusal to cash a valid check drawn against a solvent account on deposit in the bank. The appellate court affirmed the trial court's dismissal of the checkholder's action, and agreed with the defendants that, pursuant to section 3-409 of the Code, the defendants owed no duty to the plaintiff holder.⁹⁴ The court thus concluded that the plaintiff's remedy "was 'against the drawers and indorsers,' not the defendant bank and its agent, neither of

⁸⁸ U.C.C. § 3-401(1) (1978).

⁸⁹ See, e.g., *Goldberg v. Lowe*, 509 F. Supp. 412, 422 (N.D. Miss. 1981) (under § 3-401, signature on note creates personal liability); *Bank of Waverly v. City Bank & Trust Co.*, 600 S.W.2d 630, 632 (Mo. Ct. App. 1980) (dictum) (drawee not liable on instrument until his signature appears thereon).

⁹⁰ U.C.C. § 3-409 (1978).

⁹¹ See, e.g., *Sabin Meyer Regional Sales Corp. v. Citizens Bank*, 502 F. Supp. 557, 558 (N.D. Ga. 1980); *First City Nat'l Bank v. Long-Lewis Hardware Co.*, 363 So. 2d 762, 765 (Ala. Civ. App. 1977), *rev'd on other grounds*, 363 So. 2d 770 (Ala. 1978); *Barnett Bank v. Capital City First Nat'l Bank*, 348 So. 2d 643, 644 (Fla. Dist. Ct. App. 1977); *Brown v. South Shore Nat'l Bank*, 1 Ill. App. 3d 136, —, 273 N.E.2d 671, 673 (1971); *Willow City Farmers Elevator v. Vogel, Vogel, Brantner & Kelly*, 268 N.W.2d 762, 766 (N.D. 1978) (dictum).

⁹² 138 Ga. App. 209, 225 S.E.2d 761 (1976).

⁹³ *Id.* at 211, 225 S.E.2d at 762.

⁹⁴ *Id.* at 210-11, 225 S.E.2d at 762-63.

whom owed him a duty."⁹⁵

Despite the case authority suggesting otherwise, it is not clear that the Code addresses the issue of a bank's liability to a checkholder, *apart from the instrument*, when it wrongfully refuses to pay a check even though sufficient funds are on hand. It is clear that under the UCC a drawee bank is not liable on the instrument until acceptance.⁹⁶ But what if a checkholder does not sue on the instrument, and instead bases his action against the drawee upon a third party beneficiary theory or a tort theory? Does the Code preclude such an action?

There is a reasonable argument that section 4-402, which provides that a bank is liable to its *customer* for wrongful dishonor, prohibits an action by anyone other than a customer for a bank's wrongful refusal to pay a check. This appears to be the way several courts recently have interpreted the provision.⁹⁷ On the other hand, section 4-402 might merely be intended to state a damages rule for wrongful dishonor of checks when the customer sues the drawee, the most common situation, without considering whether a duty might be owed to noncustomers. Prior to the Code, courts made a distinction in the measure of damages sustained by a depositor whose check was dishonored according to whether the depositor was a "trader" or a "nontrader."⁹⁸ There was also some confusion over whether the wrongful dishonor of a check could be considered the "proximate cause" of the arrest and prosecution of

⁹⁵ *Id.* at 211, 225 S.E.2d at 762 (citation omitted). In addition to the three Code provisions previously mentioned, sections 3-104 and 3-507 have been brought into play by courts contending that a holder may not maintain a cause of action for wrongful dishonor. *See, e.g., Central Bank Nat'l Ass'n v. Federal Home Loan Bank*, 430 F. Supp. 1080, 1084 (N.D. Cal. 1977) (construing section 3-104's definition of "check"), *vacated*, 620 F.2d 309 (9th Cir. 1980); *Stewart*, 138 Ga. App. at 211, 225 S.E.2d at 762 (interpreting section 3-507 definition of "dishonor"). As these provisions are merely definitional, they will not be analyzed in this Article.

⁹⁶ *See* U.C.C. § 3-409(1) (1978); *supra* note 90 and accompanying text.

⁹⁷ *See, e.g., Goldberg v. Lowe*, 509 F. Supp. 412, 422 (N.D. Miss. 1981).

⁹⁸ *See, e.g., Third Nat'l Bank v. Ober*, 178 F. 678, 678-80 (8th Cir. 1910); *First Nat'l Bank v. N.R. McFall & Co.*, 144 Ark. 149, 151, 222 S.W. 40, 41 (1920). There is a presumption that substantial damages have been sustained when a check drawn by a merchant or trader is wrongfully dishonored. *Ober*, 178 F. at 678-80. The rationale for this rule is that wrongful dishonor reflects adversely upon the merchant's credit rating, and therefore constitutes a slander. *McFall*, 144 Ark. at 151, 222 S.W.2d at 41; *see also Svendsen v. State Bank*, 64 Minn. 40, 42, 65 N.W. 1086, 1087 (1896) (failure to honor merchant's check imputes insolvency); *J.M. James Co. v. Continental Nat'l Bank*, 105 Tenn. 1, 5, 58 S.W. 261, 264 (1900) (rejection by bank of merchant's check injures his business standing); *Browning v. Bank of Vernal*, 60 Utah 197, 199, 207 P. 462, 464 (1922) (failure of bank to pay on checks deposited by merchant entitles depositor to recover without proof of actual damages).

the customer.⁹⁹ It may be that the drafters of section 4-402 merely wanted to settle issues.¹⁰⁰ It is likely, however, that little thought was given by the drafters of the Code to actions by noncustomers, since pre-Code notions concerning the necessity of privity of contract had led courts to find no duty owing from the bank to anyone other than the drawer, the party with whom it had a contract.¹⁰¹ In addition, under pre-Code law the category of protected beneficiaries of third party beneficiary contracts was still rather limited.¹⁰² Therefore, the effect of pre-Code law was to make it very difficult for anyone but the customer to recover from a bank for wrongful refusal to honor a check.¹⁰³

⁹⁹ Compare *Weaver v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 59 Cal. 2d 428, 431, 380 P.2d 644, 651, 30 Cal. Rptr. 4, 9 (1963) (bank's failure to honor check had sufficient causal connection to subsequent arrest of plaintiff) and *Collins v. City Nat'l Bank & Trust Co.*, 131 Conn. 167, 169, 38 A.2d 582, 584 (1944) (jury reasonably could find proximate cause) with *Waggoner v. Bank of Bernie*, 220 Mo. App. 165, 167, 281 S.W. 130, 132 (1926) (arrest not expected to follow wrongful dishonor when investigation would disclose that a mistake had been made) and *Western Nat'l Bank v. White*, 62 Tex. Civ. App. 374, 376, 131 S.W. 828, 830 (1910) (appellant could not reasonably have contemplated that arrest would result from wrongful dishonor of check).

¹⁰⁰ See U.C.C. § 4-402 official comment 3 (1978) (repudiating cases allowing substantial damages to merchants and traders without actual proof); *id.* official comment 5 (determinations that wrongful dishonor of check is not the proximate cause of customer's arrest are questions of fact for the jury); see also *Wrongful Dishonor of a Check: Payor Bank's Liability Under Section 4-402*, 11 B.C. INDUS. & COM. L. REV. 116, 121-27 (1969) (objective of section 4-402 was to provide clear standards for awarding damages).

¹⁰¹ See *supra* note 80 and accompanying text.

¹⁰² For a discussion of the development of the law of third party beneficiaries prior to the UCC, see *infra* notes 116-33 and accompanying text.

¹⁰³ See, e.g., *Bank of the Republic v. Millard*, 77 U.S. (10 Wall.) 152, 156 (1869) (holder of check has no foundation for an action against drawee bank absent privity of contract); *Southern Trust Co. v. American Bank of Commerce & Trust Co.*, 148 Ark. 283, 284, 229 S.W. 1026, 1027 (1921) (payee of unaccepted check has no action against drawee bank); cf. *Leary v. Citizens & Mfrs. Nat'l Bank*, 123 Conn. 475, 477, 23 A.2d 863, 865 (1942) (contract between bank and depositor does not benefit every checkholder by implication of law). Under pre-Code law, noncustomers were permitted to recover from the bank if they were "directly defamed." See, e.g., *Macrum v. Security Trust & Sav. Co.*, 221 Ala. 419, 423, 129 So. 74, 77 (1930). In *Macrum*, the plaintiff was the manager of a company that had an account with the defendant bank. *Id.* at 420, 129 So. at 75. The check the plaintiff issued in his company's name was wrongfully dishonored by the bank. *Id.* The court allowed the plaintiff to recover since he personally was affected by the imputation of lax business practices. *Id.* at 424, 129 So. at 78. The court observed:

The act of giving a worthless check, as affects its morals, was that of plaintiff personally. The conduct of the bank could be construed as a claim that plaintiff in a representative or official capacity had thus drawn a check of the depositor which had no funds subject to it, and was therefore an act of dishonesty and bad faith on his part, as an individual. If this is a defamation by conduct of the depositor, the jury could infer that it was such of plaintiff also.

Since the enactment of the Code, however, there have been some significant legal developments in these areas. As Professors Murphy and Speidel recently noted:

One of the most dramatic legal developments in recent decades has involved the enlargement of the rights of third parties not in "privity" with the defendant. One facet is the growing enlargement of the category of protected beneficiaries of third party beneficiary contracts. Even more spectacular has been the expansion of tort recovery by third persons In the area of contracted-for services there has been scant recognition of strict liability to third persons, but there has been a pronounced extension of liability predicated upon the contractor's negligence in performing promised service.¹⁰⁴

Thus, while section 4-402 states a damages rule for those potential plaintiffs under the law as it existed when that section was first drafted, it is unlikely that the drafters intended to limit forever the category of persons who might recover from a bank for wrongful dishonor of a check to those permitted such a recovery under pre-Code law.

Nor does section 3-409 necessarily prohibit a checkholder from recovering from a bank for wrongful refusal to pay a check. This section simply states that a check, of itself, does not operate as an assignment, and that the drawee is not liable on the instrument until he accepts it.¹⁰⁵ Thus, in the absence of special circumstances, the payee has no right to the funds on deposit upon the mere issuance of the check.¹⁰⁶ In the typical situation where a check is dishonored because of insufficient funds on deposit at the time of presentment, the checkholder has no action against the bank.¹⁰⁷ A payee who takes a check is relying on the credit of the drawer, and must look to him if the check is dishonored because of insufficient funds.¹⁰⁸ While the payee assumes the risk that the

Id. at 424, 129 So. at 78.

¹⁰⁴ E. MURPHY & R. SPEIDEL, *STUDIES IN CONTRACT LAW* 1380 (2d ed. 1977) (citations omitted).

¹⁰⁵ U.C.C. § 3-409(1) (1978).

¹⁰⁶ *See, e.g.,* Port City State Bank v. American Nat'l Bank, 486 F.2d 196, 201 (10th Cir. 1973); Sabin Meyer Regional Sales Corp. v. Citizens Bank, 502 F. Supp. 557, 559 (N.D. Ga. 1980); Steinbrecher v. Fairfield County Trust Co., 5 Conn. Cir. Ct. 393, 397, 255 A.2d 138, 142 (1968).

¹⁰⁷ *See* H. BAILEY, *supra* note 87, § 18.5.

¹⁰⁸ *See, e.g.,* Bank of Wyandotte v. Woodrow, 394 F. Supp. 550, 555 (W.D. Mo. 1975) (drawer liable on check upon dishonor); Bank of Venice v. Clapp, 17 Cal. App. 657, 658, 121

drawer may have insufficient funds in its account to cover the check, it is unlikely that section 3-409 was intended to require him to assume the risk that the drawee bank might negligently or even willfully fail to honor the check when sufficient funds are on hand.

Section 3-409(2) specifically provides that the section was not intended to affect liability "in contract, tort or otherwise arising [apart from the instrument] from any letter of credit or other obligation or representation which is not an acceptance."¹⁰⁹ In addition, the official comments to section 3-409 state that "[t]he section leaves unaffected any liability of any kind apart from the instrument,"¹¹⁰ and that while the drawee is not liable on the instrument until he accepts, "he remains subject to any other liability to the holder."¹¹¹ The official comments also contain illustrations of situations where a bank may be liable to a holder apart from the instrument. For example, a bank may be liable in tort for representations made, or may be liable to the holder for breach of the terms of a letter of credit.¹¹² The official comment also makes reference to section 4-302, and notes that a bank may be liable to the holder for late return of an item.¹¹³ Although no specific mention is made of possible liability for simple wrongful refusal to pay a check, there is nothing to indicate that the illustrations found in the official comment were intended to be exhaustive. Indeed, as noted above, the official comment specifically provides that the section does not affect "*any liability of any kind* apart from the instrument."¹¹⁴

A similar analysis may be used to dispel the notion that section 3-401(1) precludes an action by a payee to recover for the

P. 298, 298-99 (Dist. Ct. App. 1911) (fact that check is issued implies promise by drawer to pay face amount if bank does not); *Duncan v. Baskin*, 8 Mich. App. 509, 511, 154 N.W.2d 617, 619 (1967) (drawer promises payment of check upon dishonor and notice thereof).

¹⁰⁹ U.C.C. § 3-409(2) (1978).

¹¹⁰ *Id.* official comment 3.

¹¹¹ *Id.* official comment 2.

¹¹² *See id.*; *see also* *North Valley Bank v. National Bank*, 437 F. Supp. 70, 74 (N.D. Ill. 1977) (bank's oral representation that draft would be honored may constitute a waiver or create an estoppel).

¹¹³ *See* U.C.C. § 3-409 official comment 2 (1978); *see also* *Dozier v. First Ala. Bank*, 363 So. 2d 781, 783 (Ala. Civ. App. 1978) (retaining check past midnight deadline precludes bank from dishonoring check); *Rock Island Auction Sales, Inc. v. Empire Packing Co.*, 32 Ill. 2d 269, 271, 272, 204 N.E.2d 721, 722, 723 (1965) (payor bank accountable for amount of check not returned until after midnight deadline); *Fromer Distribs., Inc. v. Bankers Trust Co.*, 36 App. Div. 2d 840, 840, 321 N.Y.S.2d 428, 430 (2d Dep't 1971) (mem.) (failure to honor check before midnight deadline constitutes final payment).

¹¹⁴ *See* U.C.C. § 3-409 official comment 3 (1978) (emphasis added).

wrongful dishonor of a check. The official comment to section 3-401 states that "[n]othing in this section is intended to prevent any liability arising apart from the instrument" and provides illustrations of potential causes of action similar to those given in the commentary on section 3-409.¹¹⁵ In short, the Code does not prohibit a checkholder from proceeding against a bank for wrongful refusal to pay a check. Moreover, recent developments in contract and tort law suggest several theories under which a checkholder might base a cause of action.

CHECKHOLDERS AS BENEFICIARIES OF THE DRAWER'S CONTRACT WITH THE DRAWEE

Traditionally, one not a party to an agreement encountered problems when he attempted to enforce it or sought a remedy for its breach, because he was not privy to the agreement¹¹⁶ and had not contributed any consideration to the primary exchange.¹¹⁷ Gradually, courts have modified their views, and have concluded that beneficiary rights are dependent neither upon privity of contract¹¹⁸ nor upon furnishing any part of the consideration.¹¹⁹ Courts now recognize that *certain* third parties have independent rights in some contracts, although there still is some confusion regarding the circumstances under which third party beneficiaries acquire contract rights.¹²⁰

¹¹⁵ See *id.* § 3-401 official comments 1-2.

¹¹⁶ See, e.g., *Mellen v. Whipple*, 67 Mass. (1 Gray) 317, 324 (1854) (breach of contract action by third party fails for lack of privity). *But see* *Lawrence v. Fox*, 20 N.Y. 268, 274 (1859) (one not a party to agreement may enforce it against promisor if contract made for his benefit); *Brill v. Brill*, 282 Pa. 276, 278, 127 A. 840, 842 (1925) (third party has action on contract if made primarily for his benefit). See generally 4 A. CORBIN, CORBIN ON CONTRACTS § 778, at 28-31 (1951) (modern analysis of privity concept).

¹¹⁷ See 2 S. WILLISTON, *supra* note 77, § 354.

¹¹⁸ See, e.g., *Calhoun v. Downs*, 211 Cal. 766, 768, 297 P. 548, 550 (1931) (one can recover on contract made for his benefit although not a party thereto); *Fleming v. Dillon*, 370 Ill. 325, 329, 18 N.E.2d 910, 914 (1938) (third party can enforce agreement made for his benefit); *La Mourea v. Rhude*, 209 Minn. 53, 56, 295 N.W. 304, 307 (1940) (right of third party beneficiary to recover on contract suffices to give rise to privity). See generally E. FARNSWORTH, CONTRACTS § 10.2-4, at 712-34 (1982) (history of development of third party beneficiary law).

¹¹⁹ See, e.g., *Massengale v. Transatron Elec. Corp.*, 358 F.2d 83, 88 (1st Cir. 1967); *Fleming v. Dillon*, 370 Ill. 325, 329, 18 N.E.2d 910, 914 (1938); *Burns v. Washington Sav.*, 251 Miss. 789, 791, 171 So. 2d 322, 324 (1965); see also E. FARNSWORTH, *supra* note 118, § 10.2, at 714-17 (requirement that promisee furnish consideration has been repudiated in the United States).

¹²⁰ See *infra* notes 142-50 and accompanying text.

In the early stages of the development of third party beneficiary law, courts often spoke of an "intent" to benefit the third party.¹²¹ As Professor Corbin explained:

In order that a third party may sue upon a contract made by others he must show that he was intended by them to have an enforceable right or at least that the performance of the contract must necessarily be of benefit to him and such benefit must have been within the contemplation and purpose of the contracting parties.¹²²

It was generally concluded that the promisee's intent to benefit a third party was the only concern, and that the purpose and motives of the promisor could be disregarded,¹²³ at least so long as the promisor had reason to know "that such benefit was contemplated by the promisee as one of the motivating causes of his making the contract."¹²⁴

The first Restatement of Contracts classifies third party beneficiaries as either donee or creditor beneficiaries.¹²⁵ A third party is

¹²¹ See, e.g., *Austin v. Seligman*, 18 F. 519, 522 (S.D.N.Y. 1883); *Simson v. Brown*, 68 N.Y. 355, 361-62 (1877); *Union Sav. & Loan Co. v. Cook*, 127 Ohio St. 26, 29, 186 N.E. 728, 731 (1933). See generally Note, *Third Party Beneficiaries and the Restatement (Second) of Contracts*, 67 CORNELL L.J. 880, 881 (1982) (during development of third party beneficiary law, courts developed concept of "intent").

¹²² Corbin, *Contracts for the Benefit of Third Persons*, 27 YALE L.J. 1008, 1017 (1918) (footnote omitted).

¹²³ See, e.g., *Hamill v. Maryland Casualty Co.*, 209 F.2d 338, 341 (10th Cir. 1954) (mutual intent to benefit the bond company was not required for its suit on construction contract); *McCulloch v. Canadian Pac. Ry.*, 53 F. Supp. 534, 542 (D. Minn. 1943) (intent of promisee was such that promisor should be bound to perform for third party); G. GRISMORE, *CONTRACTS* 389 (rev. ed. 1965) (promisor's intention as to third party is insignificant); 2 S. WILLISTON, *supra* note 77, § 356A, at 835-36 (intent of promisee is determinative because promisee supplies the consideration); Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406, 409 (1957) (general rule that intention of promisee is controlling). But see *Spires v. Hanover Fire Ins. Co.*, 364 Pa. 52, 54, 70 A.2d 828, 830-31 (1950) (both parties must intend third party to benefit for that party to recover on contract), *overruled*, 459 A.2d 744 (Pa. 1983); Comment, *Barriers to Recovery in Pennsylvania Third Party Beneficiary Law*, 82 DICK. L. REV. 143, 158-61 (1977) (both the promisee and the promisor must intend to confer a benefit on the third party).

¹²⁴ Corbin, *Third Parties as Beneficiaries of Contractors' Surety Bonds*, 38 YALE L.J. 1, 7 (1928) [hereinafter cited as Corbin, *Third Parties as Beneficiaries*]; see also *Lucas v. Hamm*, 56 Cal. 2d 583, 587, 364 P.2d 685, 689, 15 Cal. Rptr. 821, 825 (1961) (promisor must have understanding that promisee has intent to benefit third party), *cert. denied*, 368 U.S. 987 (1962); *Peters Grazing Ass'n v. Legerski*, 544 P.2d 449, 458 (Wyo. 1975) (promisor must have understood that promisee intended to benefit third party).

¹²⁵ RESTATEMENT OF CONTRACTS § 133 (1932). Section 133 of the first Restatement reflected an acceptance of the principle that two contracting parties may create legally enforceable rights in a third party for the latter's benefit. *Id.* Following the decision of Law-

a donee beneficiary if "the purpose of the promisee in obtaining the promise . . . is to make a gift to the beneficiary or to confer upon him a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary" ¹²⁶ Conversely, a third party is a creditor beneficiary "if no purpose to make a gift appears . . . and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary" ¹²⁷ A third party not falling within one of these categories is an "incidental beneficiary," ¹²⁸ and has no rights under the contract. ¹²⁹ While this was

rence v. Fox, 20 N.Y. 268 (1859), the concept of the third party beneficiary gained increasing recognition. See, e.g., *Edwards v. Commissioner*, 102 F.2d 757, 759 (10th Cir. 1939); *American Exch. Nat. Bank v. Northern Pac. R.R. Co.*, 76 F. 130, 130 (D. Wash. 1896). Such recognition of third party rights, however, was not a universal trend. See Note, *Third Party Beneficiaries and the Intention Standard: A Search for Rational Contract Decision-Making*, 54 VA. L. REV. 1166, 1167 n.8 (1968); see also *United States ex rel. Midland Loan Fin. Co. v. National Sur. Corp.*, 103 F.2d 450, 451-52 (8th Cir. 1939) (third party generally cannot sue for breach in the absence of an enabling statute), *aff'd*, 309 U.S. 165 (1940); *Hudson v. Moonier*, 102 F.2d 96, 98 (8th Cir.) (Missouri law does not permit third party action on contract), *cert. denied*, 307 U.S. 639 (1939). In an attempt to supply a theoretical basis for third party contractual recovery, and to eliminate confusion generated by judicial attempts to use legal fictions to alleviate injustices resulting from application of the privity requirement, the Restatement of Contracts created two categories of third party beneficiaries within which to vest enforceable contractual rights—donee and creditor beneficiaries. RESTATEMENT OF CONTRACTS § 133 (1932); see Note, *supra*, at 1166-68.

¹²⁶ RESTATEMENT OF CONTRACTS § 133(1)(a) (1932); accord *United States ex rel. Johnson v. Morley Constr. Co.*, 98 F.2d 781, 788 (2d Cir.) (laborers working for a construction company under contract between United States and construction company are donee beneficiaries of the contract), *cert. denied sub nom. Maryland Casualty Co. v. United States ex rel. Harrington*, 305 U.S. 651 (1938); *Stilwell Frozen Foods, Inc. v. North British & Mercantile Ins. Co.*, 184 F. Supp. 629, 634 (W.D. Ark. 1960) (customer of storage company considered donee beneficiary with respect to insurance contract between storage company and insurer); *United States v. Dauphin Deposit Trust Co.*, 50 F. Supp. 73, 75 (M.D. Pa. 1943) (named beneficiary of United States savings bond holder is donee beneficiary of contract between United States and registered bondholder).

¹²⁷ RESTATEMENT OF CONTRACTS § 133(1)(b) (1932); accord *Ar-Tik Sys., Inc. v. Dairy Queen, Inc.*, 302 F.2d 496, 504 (3d Cir. 1962) (patent owner was creditor beneficiary under contract between licensee and licensee's assignee); *Nebraska Bridge Supply & Lumber Co. v. Deakin*, 109 Colo. 367, 369, 125 P.2d 962, 964 (1942) (bankrupt lumber seller is creditor beneficiary of contractor that assumed his debt).

¹²⁸ RESTATEMENT OF CONTRACTS § 133(1)(c) (1932); see *Johnson Farm Equip. Co. v. Cook*, 230 F.2d 119, 124 (8th Cir. 1956); *Isbrandtsen Co. v. Local 1291, Int'l Longshoremen's Ass'n*, 204 F.2d 495, 498 (3d Cir. 1953); *Coley v. English*, 235 Ark. 215, 216, 357 S.W.2d 529, 530-31 (1962).

¹²⁹ RESTATEMENT OF CONTRACTS § 147 (1932); accord *Hamilton & Spiegel, Inc. v. Board of Educ.*, 233 Md. 196, —, 195 A.2d 710, 711-12 (1963); *Spivak v. Madison-54th Realty Co.*, 60 Misc. 2d 483, 488, 303 N.Y.S.2d 128, 134 (Sup. Ct. Kings County 1969); *Johnston v. Oregon Bank*, 285 Or. 423, 427, 591 P.2d 746, 750 (1979).

generally representative of the law at the time,¹³⁰ it soon became apparent that not all third party beneficiary cases logically fall into these two relatively narrow classes of donee and creditor beneficiaries.¹³¹ In discussing the weakness of the categories, one commentator noted that "a complex fact situation is often beyond their scope."¹³² This category structure simply could not explain the result reached in many cases.¹³³

The Restatement Second of Contracts retains the term "incidental beneficiary" to describe one who acquires no rights under a contract,¹³⁴ and adopts a new term, "intended beneficiary," to describe one who does acquire rights under a contract.¹³⁵ Section 302 of the Restatement Second provides:

- (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
 - (a) the performance of the promise will satisfy an obli-

¹³⁰ See, e.g., 4 A. CORBIN, *supra* note 116, § 774, at 6 (classification of third parties with enforceable contractual rights into either donee or creditor beneficiaries was widely recognized); 2 S. WILLISTON, *supra* note 77, § 356, at 828-29 (great weight of authority acknowledges right of donee and creditor beneficiaries to enforce contracts); see also *Mutual Benefit Life Ins. Co. v. Ellis*, 125 F.2d 127, 130 (2d Cir.) (donee beneficiary may sue on contract to which he is not a party), *cert. denied*, 316 U.S. 665 (1942); *I.P.C. Distribs., Inc. v. Chicago Moving Picture Mach. Operators Union*, 132 F. Supp. 294, 297 (N.D. Ill. 1955) (acknowledging that weight of authority permits creditor beneficiaries to recover on contract).

¹³¹ See, e.g., *Hamill v. Maryland Casualty Co.*, 209 F.2d 338, 340-41 (10th Cir. 1954); *Harris v. Waikane Corp.*, 484 F. Supp. 372, 379 (D. Hawaii 1980); *McCain v. Stephens*, 80 Ariz. 306, 309, 297 P.2d 352, 355 (1956).

¹³² Note, *supra* note 125, at 1169.

¹³³ See Note, *supra* note 121, at 883-85. Judicial response to the first Restatement's classification system reflected the inadequacies and weaknesses inherent therein. *Id.* at 884. Some courts permitted recovery to third party beneficiaries notwithstanding the third party's failure to meet the definitional requirements of donee beneficiaries or creditor beneficiaries, while others interpreted the Restatement too restrictively. *Id.*

¹³⁴ RESTATEMENT (SECOND) OF CONTRACTS § 302(2) (1979); see *id.* comment e; accord *Holbrook v. Pitt*, 643 F.2d 1261, 1270 (7th Cir. 1981) (third party whom the parties did not intend to benefit considered an incidental beneficiary lacking cognizable legal rights under the contract); *Westhampton House, Inc. v. Carey*, 506 F. Supp. 215, 217 (E.D.N.Y. 1980) (third party beneficiary may not sue on a contract when the benefit merely is incidental to contract performance); *Little v. Union Trust Co.*, 45 Md. App. 178, 180, 412 A.2d 1251, 1253 (Ct. Spec. App. 1980) (incidental beneficiary has no cause of action against either promisor or promisee).

¹³⁵ RESTATEMENT (SECOND) OF CONTRACTS § 302(1) (1979); see *id.* comment a; accord *Beckman Cotton Co. v. First Nat'l Bank*, 666 F.2d 181, 183 (5th Cir. 1982) (contract beneficiary may maintain action thereon only if an intended beneficiary); *Richardson Eng'g Co. v. International Business Mach. Corp.*, 554 F. Supp. 467, 471 (D. Vt. 1981) (intended beneficiary of a lien waiver is entitled to enforce the clause containing such waiver).

gation of the promisee to pay money to the beneficiary; or
(b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

- (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.¹³⁶

Thus, the draftsmen have supplemented the old categories with a new standard, the manifestation in the original contract of an intention to benefit a third party.

If one examines the contract between a depositor and his bank, it is doubtful that any specific intent to benefit checkholders will be found. Professor Corbin concluded:

The bank contracts with the depositor to honor his checks and drafts—to pay out to his order. This contract is not made for the benefit of the holders of such checks and drafts, and does not give them a right against the bank.¹³⁷

Rather, a depositor opens a checking account primarily for his own benefit, to obtain a convenient, inexpensive, and relatively risk-free means of making payment to third parties while maintaining the fund in a safe place.¹³⁸

There has been growing criticism of the courts' preoccupation with "intent,"¹³⁹ and it has been suggested that courts should "look instead to actual reliance and commercial and social policies as the ultimate criteria for the determination of third party beneficiary controversies."¹⁴⁰ Professor Farnsworth recently observed that "[t]he law of contract beneficiaries has not been unaffected by the increasing role played by reliance in contract law."¹⁴¹ The commentary to section 302 of the Second Restatement of Contracts

¹³⁶ RESTATEMENT (SECOND) OF CONTRACTS § 302 (1979).

¹³⁷ 4 A. CORBIN, *supra* note 116, § 779F, at 52 (footnote omitted).

¹³⁸ See 5A BANKS AND BANKING, *supra* note 3, § 4a, at 25 (purpose of general deposit is to protect funds and to provide for convenience and benefit of depositor).

¹³⁹ See Jones, *Legal Protection of Third Party Beneficiaries: On Opening Courthouse Doors*, 46 U. CIN. L. REV. 313, 320 (1977); Note, *supra* note 121, at 891-92; Note, *supra* note 125, at 1172-73.

¹⁴⁰ Note, *supra* note 125, at 1174; see E. FARNSWORTH, *supra* note 118, § 10.3, at 725 (1982) (reliance aspect of contract law affecting third party beneficiary law); cf. Macaulay, *Private Legislation and the Duty to Read—Business Run by IBM Machine*, *The Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051, 1060-61 (1966) (courts should solve cases pursuant to "transactional policy" that takes into account the factors of assumption of risk and reasonable reliance); Note, *supra* note 125, at 1172 (third party beneficiary law must expand scope of inquiry to accommodate commercial needs and market policies).

¹⁴¹ E. FARNSWORTH, *supra* note 118, § 10.3, at 725.

specifically provides that "if the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary."¹⁴² Farnsworth, pointing to this comment and to section 90 of the Second Restatement, which speaks of reliance by "action or forbearance on the part of a promisee or third person,"¹⁴³ concludes that "even though a third person is not an intended beneficiary of a promise, his reliance on the promise may give him a right against the promisor."¹⁴⁴ Moreover, at least one court has relied on the language of section 90 in upholding recovery by a third person who had relied on an agreement between other persons.¹⁴⁵ No one has suggested that a third party can make himself a beneficiary merely by acting in reliance upon a contract.¹⁴⁶ A third party, however, should have rights under a contract where that contract creates reasonable expectations on his part and induces him to change his position in reliance upon it.¹⁴⁷

If one focuses on the "reasonable expectations" of a checkholder, it is clear that he should have rights under the contract between the depositor and his bank. Although courts now speak of an express or implied contract that obligates the bank to honor its depositors' checks,¹⁴⁸ they long have recognized the "uni-

¹⁴² RESTATEMENT (SECOND) OF CONTRACTS § 302 comment d (1979); *accord* Commercial Ins. Co. v. Pacific-Peru Constr. Corp., 558 F.2d 948, 953-54 (9th Cir. 1977); Guy v. Liederbach, 279 Pa. Super. 543, 547, 421 A.2d 333, 337 (1980).

¹⁴³ RESTATEMENT (SECOND) OF CONTRACTS § 90 (1979). Section 90(1) provides, in part:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

Id.

¹⁴⁴ E. FARNSWORTH, *supra* note 118, § 10.3, at 725; *accord* Note, *supra* note 125, at 1188-89 (upon establishment of justifiable reliance, third party has action against promisor). *But cf.* Boyer, *Promissory Estoppel: Requirements and Limitations of the Doctrine*, 98 U. PA. L. REV. 459, 465 (1950) ("[i]t asks too much of a promisor to require that he consider whether or not his promise will induce action by a *third party*") (emphasis in original).

¹⁴⁵ See Aronowicz v. Nalley's, Inc., 30 Cal. App. 3d 27, 44-45, 106 Cal. Rptr. 424, 434-35 (1973) (promisor who knew of third parties' justifiable reliance is to be estopped from denying validity of action commenced by third party). *But cf.* C.R. Frederick, Inc. v. Sterling-Salem Corp., 507 F.2d 319, 322 (9th Cir. 1974) (courts have been cautious in applying the principles of section 90 to third party beneficiary cases).

¹⁴⁶ See, e.g., White v. Alaska Ins. Guar. Ass'n, 592 P.2d 367, 369 (Alaska 1979); Kirst v. Silna, 103 Cal. App. 3d 759, 763, 163 Cal. Rptr. 230, 232 (1980).

¹⁴⁷ See 4 A. CORBIN, *supra* note 116, § 775, at 8; E. FARNSWORTH, *supra* note 118, § 10.3, at 725.

¹⁴⁸ See Ma v. Community Bank, 494 F. Supp. 252, 256 (E.D. Wis. 1980), *modified on appeal*, 686 F.2d 459 (7th Cir. 1982); Peterson v. Carstensen, 249 N.W.2d 622, 624 (Iowa 1977); Brigham v. McCabe, 20 N.Y.2d 525, 530-31, 232 N.E.2d 327, 330, 285 N.Y.S.2d 294,

versal usage" of banks to cash checks drawn by depositors when sufficient funds are on hand.¹⁴⁹ Hence, while a party taking a check does rely upon the credit of the parties to that instrument, he takes the check on the understanding that as long as sufficient funds are available, and payment has not been stopped by the drawer, the check will be honored by the bank.¹⁵⁰ Banks certainly are aware of this understanding, and of the expectations of checkholders. Thus, where a checkholder reasonably relies on the agreement between a depositor and his bank, and the promisor bank is fully aware of this reliance, the checkholder should be granted rights under the agreement.

LIABILITY BASED UPON NEGLIGENCE

At common law, in the absence of privity, a party could not maintain an action in tort for harm caused by another's negligent performance of a contract.¹⁵¹ Thus, professional and commercial enterprises owed no common-law duty to non-contracting parties.¹⁵² This generally included banks, which were found to owe no

298 (1967).

¹⁴⁹ See, e.g., *Cincinnati, H. & D. R.R. v. Metropolitan Nat'l Bank*, 54 Ohio St. 60, 61, 42 N.E. 700, 701 (1896) ("universal usage of banks to cash the checks drawn by a depositor where he has sufficient unincumbered balance standing to his credit"); see also *United States Shipping Bd. Emergency Fleet Corp. v. Atlantic*, 5 F.2d 529, 532 (D. Mass. 1925) (bank obligated to honor checks of depositor as long as sufficient funds exist); *Castaline v. National City Bank*, 244 Mass. 416, 417, 138 N.E. 398, 398 (1923) (bank is bound to honor checks of depositor if sufficient unencumbered funds exist).

¹⁵⁰ See 5A *BANKS AND BANKING*, *supra* note 3, § 204, at 544-49 (holder naturally expects check to be honored, provided that sufficient funds exist and that check has not been stopped); see also *H. BAILEY*, *supra* note 87, § 18.3 (holder expects to be paid with drawer's funds); *M. BIGELOW*, *THE LAW OF BILLS, NOTES, AND CHECKS* §§ 225-229 (3d ed. 1928) (holder expects drawer to have sufficient funds to cover check).

¹⁵¹ See *W. PROSSER*, *HANDBOOK OF THE LAW OF TORTS* § 93, at 622 (4th ed. 1971) ("general rule, which prevailed into the twentieth century, [was] that there was no liability of a contracting party to one with whom he was not in 'privity'"); see also *Winterbottom v. Wright*, 152 Eng. Rep. 402, 405 (1842) (breach of contract with respect to a failure to keep a mailcoach in proper repair provided no legal recourse against manufacturer to injured passenger); *National Sav. Bank v. Ward*, 100 U.S. 195, 203 (1879) (no liability to third party for loss sustained by virtue of reliance on a negligently prepared title abstract because of lack of privity).

¹⁵² See, e.g., *Ford v. Sturgis*, 14 F.2d 253, 255 (D.C. Cir. 1926) (building contractor's negligence does not render him liable to third person killed by building's collapse); *Buckley v. Gray*, 110 Cal. 339, 339, 42 P. 900, 900 (1895) (attorney not liable to third person deprived of portion of an estate due to attorney's negligence in drafting will); *Landell v. Lybrand*, 264 Pa. 406, 406, 107 A. 783, 783 (1919) (company accountant not liable to investors who bought shares in company on basis of his report).

duty to noncustomers.¹⁵³

The privity requirement reflected more than a mere clinging to ancient historical concepts. One writer observed:

The privity requirement reflects the philosophical beliefs of nineteenth century common law. Contract law in the nineteenth century had its roots in the free enterprise theory that presupposed that a duty should arise only by the will of the individual contracting freely. Reflecting these beliefs, the privity doctrine became a valuable tool in accomplishing the joint goals of industrialization and professional development.¹⁵⁴

Courts were concerned with protecting the fledgling industrial revolution, and the various emerging professional and commercial enterprises.¹⁵⁵ The fear of the impact of indeterminate liability on business greatly influenced the courts.¹⁵⁶

A clear expression of this concern can be found in *Ultramares Corp. v. Touche*,¹⁵⁷ where a party who had relied on a negligently prepared audit was denied recovery for his economic losses because

¹⁵³ See, e.g., *Laclede Bank v. Schuler*, 120 U.S. 511, 514 (1887) (holder cannot maintain action against bank on an unaccepted check, since in that situation the holder is not in privity with the bank); *Bank of Republic v. Millard*, 77 U.S. (10 Wall.) 152, 156 (1869) (no foundation for action commenced by checkholder against a bank without privity); *Cincinnati, H. & D.R.R. v. Metropolitan Nat'l Bank*, 54 Ohio St. 60, 62, 42 N.E. 700, 703 (1896) (until a check is accepted holder cannot maintain an action against the bank because the latter owes the holder no legal duty).

¹⁵⁴ Comment, *Liability to Third Parties for Economic Injury: Privity as a Useful Animal, or a Blind Imitation of the Past*, 12 Sw. L. Rev. 87, 118 (1981); see also Rintala, *The Supreme Court of California 1968-1969 Foreword: "Status" Concepts in the Law of Torts*, 58 CALIF. L. REV. 80, 83-84 (1970) (nineteenth century values of maximizing individual freedom and encouraging economic progress reflected in the concept of imposing liability only on a party that unreasonably creates a foreseeable risk of harm to another and only when the relationship between the parties so warrants).

¹⁵⁵ See Seavey, *Mr. Justice Cardozo and the Law of Torts*, 52 HARV. L. REV. 372, 379 (1939). Professor Seavey suggests that the landmark decision *Winterbottom v. Wright* and its immediate progeny exemplify protective judicial legislation afforded manufacturers who were unable to pay for the consequences of their employees' mistakes. *Id.*; see also W. PROSSER, *supra* note 151, § 96, at 622 (privity rule of *Winterbottom v. Wright* was a reflection of 19th-century concern that imposing liability on manufacturers for injuries caused to non-immediate buyers would burden them too heavily).

¹⁵⁶ W. PROSSER, *supra* note 151, §§ 93, 96 ("fear of burdening defendants with a crushing responsibility" has led many courts to deny liability in the absence of privity of contract). American courts were greatly influenced by the forebodings of Lord Abinger in *Winterbottom v. Wright*, where he observed that "the most absurd and outrageous consequences" were likely to occur, "unless we confine the operation of such contracts as this to the parties entered into them." *Winterbottom v. Wright*, 152 Eng. Rep. 402, 405 (1842); see *infra* notes 161-165 and accompanying text.

¹⁵⁷ 255 N.Y. 170, 174 N.E. 441 (1931).

he lacked privity with the accountant.¹⁵⁸ Judge Cardozo expressed the concern that:

[I]f liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.¹⁵⁹

This same concern was articulated by courts considering the liability of a bank to a checkholder for wrongful dishonor.¹⁶⁰ The Supreme Court even suggested that if checkholders were permitted to sue banks for wrongful dishonor, then "bankers would be compelled to abandon altogether the business of keeping deposit accounts for their customers."¹⁶¹

Cost and risk spreading factors were not considered by these courts.¹⁶² As malpractice and other types of protective insurance

¹⁵⁸ *Id.* at 188-89, 174 N.E. at 448. Fred Stern & Co. (Stern), a rubber importer, hired Touche, Niven & Co. (Touche), the defendant accounting firm, to prepare and certify, pursuant to an audit, a balance sheet representing "a true and correct view" of Stern's net worth. *Id.* at 173-74, 174 N.E. at 442. Touche knew that Stern would exhibit the certified balance sheet to banks, creditors, stockholders, and merchants in order to borrow money and obtain the extensive credit necessary to finance operations. *Id.* Nevertheless, it certified Stern's net worth at over one million dollars when in reality the corporation was insolvent. *Id.* at 173-75, 174 N.E. at 442. Although Stern had falsified its books by setting forth fictitious assets, a jury could have found that closer inquiry by the defendant would have revealed the company's true financial status. *Id.* at 175, 174 N.E. at 442-43. On the strength of Touche's certificate, however, the plaintiff corporation advanced large sums of money to Stern for rubber purchases in exchange for executory assignments of payments arising from future sales. *Id.* Because of Stern's true financial status, the security for some of these loans was either inadequate or nonexistent. *Id.* at 175-76, 174 N.E. at 443. When "the house of cards collapsed," the plaintiff sued the accounting firm in both fraud and negligence, seeking recovery for losses incurred in reliance on the certificate. *Id.* at 176, 174 N.E. at 443. The New York Court of Appeals refused to impose the same duty of care on the accounting firm toward indeterminate third parties as on parties linked by contract, holding that absent a contractual relationship liability for misstatement could be predicated only upon fraud. *Id.* at 179-81, 174 N.E. at 444-45.

¹⁵⁹ *Id.* at 179, 174 N.E. at 444.

¹⁶⁰ See, e.g., *Bank of the Republic v. Millard*, 77 U.S. (10 Wall.) 152, 157 (1869) (finding privity between banker and holder may result in recognizing a "right of action upon one promise for the same thing, existing in two distinct persons at the same time").

¹⁶¹ *Id.* For a brief discussion of the *Millard* Court's repudiation of the third party beneficiary, see *supra* notes 32-34 and accompanying text.

¹⁶² See W. PROSSER, *supra* note 151, § 83, at 547 (despite commentators' insistence that risk-spreading factors are revolutionizing tort law, little impact of these factors can be discerned in judicial decisions); Comment, *supra* note 154, at 123-24 (courts should consider risk-spreading factors when assessing third party recovery instead of relying on "the artificial and inflexible bar of privity"). But see Freezer, *Capacity to Bear Loss as a Factor in the Decision of Certain Types of Tort Cases*, 78 U. PA. L. REV. 805, 810 (1930) (a growing

became available, however, the privity requirement began to erode.¹⁶³ This erosion was fueled by recognition of the changes in the social and economic structure of our society and in the public nature of professional and commercial enterprises.¹⁶⁴ Today, it is generally acknowledged that the increased size and power of American business warrants increased responsibility.

In 1931, Judge Cardozo wrote that "[t]he assault upon the citadel of privity is proceeding in these days apace."¹⁶⁵ This assault has been well-documented elsewhere.¹⁶⁶ It has been particularly successful where negligence actions are brought by third persons who have suffered personal injury¹⁶⁷ or property damage.¹⁶⁸ Where

number of courts consider capacity to bear the loss as a factor in making awards).

¹⁶³ McNiece & Thornton, *Is the Law of Negligence Obsolete?*, 26 ST. JOHN'S L. REV. 255, 260-61, 265 (1952) (expansion of liability to third parties may not have been "directly traceable" to the increase of liability insurance but it was an "important consideration" of the judiciary in making these changes); see also Besser, *Privity?—An Obsolete Approach to the Liability of Accountants to Third Parties*, 7 SETON HALL L. REV. 507, 534-35 & nn. 114-15 (1976) (rationale for continued reliance on privity doctrine based on fear of prohibitive cost or unavailability of malpractice insurance refuted by recent surveys showing use and affordability of such insurance) (citing PLI, PROFESSIONAL LIABILITY INSURANCE FOR LAWYERS AND ACCOUNTANTS 259-73 (1976)). But see Comment, *Auditors' Third Party Liability: An Ill-Considered Extension of the Law*, 46 WASH. L. REV. 675, 698-705 (1971) (extended liability will inflate insurance rates, adversely affecting small businesses and national economy).

¹⁶⁴ See Tobriner, *Retrospect: Ten Years on the California Supreme Court*, 20 UCLA L. REV. 5, 12 (1972) (courts responding to economic and social tensions that "press upon the legal status quo" have begun to forge a status-based liability for public enterprises); Comment, *supra* note 154, at 119-20 (contemporary changes in professional, commercial, and industrial enterprises since *Ultramares* decision require expansion of liability to protect third parties); see also Rintala, *supra* note 154, at 83-92 (socioeconomic changes have rendered privity doctrine obsolete); Note, *Accountants' Liability to Third Parties for an Audit*, 52 MARQ. L. REV. 158, 161-62 (1968) (privity outmoded by changes in the size and organization of business).

¹⁶⁵ *Ultramares Corp. v. Touche*, 255 N.Y. 170, 180, 174 N.E. 441, 445 (1931).

¹⁶⁶ See, e.g., Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791, 791-800, 817-20 (1966) (documenting death of privity requirement in products liability actions) [hereinafter cited as Prosser, *The Fall of the Citadel*]; Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1099 (1960); Note, *supra* note 164, at 160-63 (discussing alternatives to and various views of viability of privity doctrine).

¹⁶⁷ Prosser, *The Fall of the Citadel*, *supra* note 166, at 820-22; see, e.g., *Dagley v. Armstrong Rubber Co.*, 344 F.2d 245, 252 (1965) (administrator of truck driver's estate recovered damages for wrongful death against tire manufacturer despite lack of privity), *aff'd*, 371 F.2d 205 (7th Cir. 1966); *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 394, 111 N.E. 1050, 1054-55 (1916) (automobile manufacturer held liable for personal injuries to car owner caused by defective wheel).

¹⁶⁸ Prosser, *The Fall of the Citadel*, *supra* note 166, at 820-22; see, e.g., *Todd Shipyards Corp. v. United States*, 69 F. Supp. 609, 610 (D. Me. 1947) (expanding *MacPherson* holding to encompass property damage); *Steinberg v. Coda Roberson Constr. Co.*, 79 N.M.

a party not in privity seeks to recover for mere economic loss, however, the assault has proceeded more slowly to avoid opening the door to unlimited liability.¹⁶⁹ Professor James explains the courts' reluctance to so extend liability, noting that "the physical consequences of negligence usually have been limited, but indirect economic repercussions of negligence may be far wider, indeed virtually open-ended."¹⁷⁰

Nevertheless, in recent years, an increasing number of courts have permitted recovery for purely economic injuries caused by the negligent torts of third parties.¹⁷¹ Because of the fear of indeterminate liability, however, liability generally has been circumscribed by a foreseeability standard,¹⁷² with some courts requiring actual reliance by third persons within the contemplation of the parties when the transaction took place or the services were rendered.¹⁷³ In *Biakanja v. Irving*,¹⁷⁴ the California Supreme Court employed a balancing approach to determine whether recovery should be extended to economically injured parties who are not in privity of contract with their defendants.¹⁷⁵ This approach has received the approval of numerous courts across the country, as it provides a

123, 124, 440 P.2d 798, 799 (1968) (privity not essential to recovery for economic loss arising from negligent construction); *Gosnell v. Zink*, 325 P.2d 965, 967 (Okla. 1958) (permitting plaintiff to recover for property damage resulting from fire caused by furnace negligently manufactured by defendant).

¹⁶⁹ See Besser, *supra* note 163, at 510-12; Comment, *supra* note 154, at 89.

¹⁷⁰ James, *Limitations on Liability For Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 45 (1972).

¹⁷¹ See, e.g., *Hoskins v. Jackson Grain Co.*, 63 So. 2d 514, 516 (Fla. 1953) (farmer may recover business losses against wholesaler that misnamed seeds); *Santor v. A & M Karagheusian, Inc.*, 44 N.J. 52, 63, 207 A.2d 305, 310 (1965) (ultimate purchaser of carpet may recover against manufacturer for breach of implied warranty of reasonable fitness); *Mazetti v. Armour & Co.*, 75 Wash. 662, 664, 135 P. 633, 636 (1913) (restaurant owner has cause of action against food manufacturer for business losses resulting from reputation of serving bad food).

¹⁷² See, e.g., *Licata v. Spector*, 26 Conn. Supp. 378, 379, 225 A.2d 28, 29-30 (Super. Ct. 1966) (liability imposed on attorney whose negligent will drafting deprived third party of legacy, since plaintiff's existence and reliance were foreseeable); *Craig v. Everett M. Brooks Co.*, 351 Mass. 497, 500, 222 N.E.2d 752, 755 (1967) (third party plaintiff may recover for economic loss where type and extent of damage were foreseeable); *Glanzer v. Shepard*, 233 N.Y. 236, 240-42, 135 N.E. 275, 276-77 (1922) (contract requiring defendant weigher to certify weight of bean shipment for sole benefit of and delivery to third party gave that party an actionable negligence claim for economic loss, since the prospective use of the shipment was known).

¹⁷³ See, e.g., *Ryan v. Kanne*, 170 N.W.2d 395, 401-03 (Iowa 1969) (lack of privity no bar to recovery by third party who specifically relied on accountant's financial statements).

¹⁷⁴ 49 Cal. 2d 647, 320 P.2d 16 (1958).

¹⁷⁵ *Id.* at 650, 320 P.2d at 19.

flexible and workable test for determining when liability should be extended to certain third parties.¹⁷⁶

In *Biakanja*, an attorney failed to have the will he prepared properly attested, because he mistakenly believed that a notarial seal could be used as a substitute for witnesses.¹⁷⁷ The will was denied probate and the plaintiff, instead of receiving all the property as bequeathed, received only one-eighth of the estate by intestate succession.¹⁷⁸ The court concluded that whether a defendant should be liable to a third person not in privity is a matter of policy and involved the balancing of various factors, which included the following:

- (1) "the extent to which the transaction was intended to affect the plaintiff,"
- (2) "the foreseeability of harm to him,"
- (3) "the degree of certainty that the plaintiff suffered injury,"
- (4) "the closeness of the connection between the defendant's conduct and the injury suffered,"
- (5) "the moral blame attached to the defendant's conduct, and"
- (6) "the policy of preventing future harm."¹⁷⁹

The court noted that "the 'end and aim' of the transaction was to provide for the passing of [the decedent's] estate to plaintiff,"¹⁸⁰

¹⁷⁶ See, e.g., *Union Oil Co. v. Oppen*, 501 F.2d 558, 566-67 (9th Cir. 1974) (applying *Biakanja* balancing test to hold oil company liable to fishermen for economic loss resulting from negligent oil spills); *Lucas v. Hamm*, 56 Cal. 2d 583, 585-86, 364 P.2d 685, 687-88, 15 Cal. Rptr. 821, 823 (1961) (using *Biakanja* balancing test to determine liability of attorney to beneficiaries of will), *cert. denied*, 368 U.S. 987 (1962); *Guy v. Liederbach*, 279 Pa. Super. 543, 545, 421 A.2d 333, 335 (1980) (utilizing California's balancing test instead of privity doctrine in determining attorney's liability to third party). Commentators have also approved of the *Biakanja* balancing test. See, e.g., Besser, *supra* note 163, at 522-24. (*Biakanja* provides workable test to free professional liability actions from privity restrictions); Note, *Negligent Interference with Economic Expectancy: The Case for Recovery*, 16 STAN. L. REV. 664, 693-94 (1964) (relaxing of the rule against recovery for negligent interference with economic expectancy recommended in *Biakanja* will serve interests of society); Comment, *supra* note 154, at 128 (*Biakanja* provides "a consistent approach to third party recovery for economic injury").

¹⁷⁷ 49 Cal. 2d at 649, 320 P.2d at 18.

¹⁷⁸ *Id.* at 648, 320 P.2d at 17.

¹⁷⁹ *Id.* at 650, 320 P.2d at 19.

¹⁸⁰ *Id.* at 649, 320 P.2d at 19 (quoting *Glanzer v. Shepard*, 233 N.Y. 236, 241, 135 N.E. 275, 277 (1922)). The *Biakanja* court concluded that the defendant must have known when he notarized the will that error on his part would result in loss to the plaintiff, and must have known what the nature and extent of this loss would be. 49 Cal. 2d at 649, 320 P.2d at 19. The court also noted that causation was established. *Id.* at 648, 320 P.2d at 19. The court distinguished the facts at issue from those in *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931). *Biakanja*, 49 Cal. 2d at 648, 320 P.2d at 19. In *Ultramares* the

and after considering the various factors concluded that the plaintiff should be allowed recovery despite the absence of privity.¹⁸¹ While *Biakanja* dealt specifically with attorney negligence, its rationale has since been extended to other types of professional and commercial negligence, including bank negligence.¹⁸²

For example, in *Robinson v. Colebrook Guaranty Savings Bank*,¹⁸³ the plaintiff brought an action against a bank for its negligent failure to advise its depositor properly regarding the establishment of a survivorship account for the benefit of the plaintiff.¹⁸⁴ After discussing *Biakanja*, the court concluded that the transaction "gave rise to a relationship between the defendant and the plaintiff, calling for the exercise of care by the defendant to prevent the injury which the plaintiff later suffered."¹⁸⁵ The court recognized that considerations surrounding the establishment of survivorship accounts were well known to persons engaged in the banking business and concluded that "[o]rdinary care required that the defendant take reasonable measures to avoid the injury

potential advantage from the contract was collateral to the transaction, whereas in *Biakanja* the focal point of the notary's action was a benefit to the plaintiff. *Id.* at 649, 320 P.2d at 19. Moreover, the plaintiff corporation in *Ultramares* suffered economic loss, but neither the extent of this loss, nor the existence of the plaintiff itself could reasonably be foreseen. *Ultramares Corp. v. Touche*, 255 N.Y. 170, 181, 174 N.E. 441, 445 (1931). In *Biakanja*, however, both the existence of the plaintiff and of his loss were foreseeable. 49 Cal. 2d at 649, 320 P.2d at 19.

¹⁸¹ See, e.g., *Union Oil Co. v. Oppen*, 501 F.2d 558, 569 (9th Cir. 1974) (oil company); *Sabella v. Wisler*, 59 Cal. 2d 21, 25, 377 P.2d 889, 893, 27 Cal. Rptr. 689, 693 (1963) (contractors); *Kent v. Bartlett*, 49 Cal. App. 3d 724, 728-30, 122 Cal. Rptr. 615, 617-18 (1975) (surveyors); *Rhodes-Haverty Partnership v. Robert & Co.*, 293 S.E.2d 876, 878 (Ga. Ct. App. 1982) (architectural and engineering firm), *aff'd*, 300 S.E.2d 503 (Ga. 1983); *Pelham v. Griesheimer*, 93 Ill. App. 3d 751, 755, 417 N.E.2d 882, 885-86 (1981) (attorney); *Stewart v. Sbarro*, 142 N.J. Super. 581, 588, 362 A.2d 581, 588, (attorneys), *cert. denied*, 72 N.J. 459, 371 A.2d 63 (1976).

¹⁸² See, e.g., *Robinson v. Colebrook Guar. Sav. Bank*, 109 N.H. 382, 384, 254 A.2d 837, 839 (1969); *Connor v. Great W. Sav. & Loan Ass'n*, 73 Cal. Rptr. 369, 377-78, 447 P.2d 609, 617-18 (1968).

¹⁸³ 109 N.H. 382, 254 A.2d 837 (1969).

¹⁸⁴ *Id.* at 384, 254 A.2d at 839.

¹⁸⁵ *Id.* at 383, 254 A.2d at 838. In *Robinson*, the depositor wanted to open an account of such a nature that the funds therein would pass to the plaintiff upon his death. *Id.* at 384, 254 A.2d at 838. Though the bank advised him that a joint account with right of survivorship was the typical way this result was accomplished, an ordinary account, designated as payable to the plaintiff on the depositor's death, was set up at the depositor's insistence. *Id.* at 383, 254 A.2d at 838. It was held that since the account was not a joint account, it did not become the plaintiff's property on the depositor's death, and the bank was alleged to have been negligent in failing to consult legal counsel as to the effect of the type of account established. *Id.* at 383, 254 A.2d at 838-39.

which would result to the plaintiff by frustration of the depositor's intent."¹⁸⁶

When the various *Biakanja* factors are considered, it is clear that a bank should be required to exercise ordinary care to avoid injuring checkholders. Persons engaged in the banking business understand that depositors will be issuing checks to third parties, and it is foreseeable that these parties may be injured by a wrongful dishonor. The connection between the bank's action and the injury suffered is clear. While a bank that mistakenly dishonors a check may not have acted in a morally reprehensible manner, as between the negligent bank and the innocent checkholder it would seem that the bank should bear the loss.

Furthermore, recognition of liability would not impose an undue burden on the banking industry. As discussed earlier, when a check has been dishonored the checkholder will seldom find it necessary to resort to an action against the drawee bank.¹⁸⁷ Most often, he will simply notify the drawer of the dishonor. The drawer will then contact the drawee bank and see that the checkholder is paid. If there are other parties to the instrument, the checkholder may look to them for payment. Permitting a checkholder to recover from a bank when necessary, however, will not seriously burden the banking business. Certainly an innocent reliant party is less capable of bearing a loss caused by a bank's negligence than the bank itself, which can insure against its losses and, if necessary, pass the cost of such insurance onto its customers.

CONCLUSION

For the past one hundred years in this country, the only assurance that checks would not be negligently or even capriciously dishonored by the drawee has been found solely in the drawer's cause of action against the drawee for wrongful dishonor. This Article suggests that this conclusion is not dictated by the Uniform Commercial Code. While a clear rule that the drawee is under no liability to the checkholder provides an element of certainty, and eliminates the need to resolve issues of "ordinary care" and "foreseeable

¹⁸⁶ *Id.* The *Robinson* court found that the depositor placed no reliance on the bank to accomplish the result he sought, and in fact had ignored the bank's warnings about the risk of injury to the plaintiff. *Id.* at 385, 254 A.2d at 840. The plaintiff's loss, therefore, was not caused by any negligence on the part of the bank. *Id.*

¹⁸⁷ See *supra* notes 8-9 and accompanying text.

damages," this certainty provides little comfort to an injured checkholder who has no remedy. Recent developments in contract and tort law, particularly the latter, provide a theoretical framework for imposing liability on negligent banks. Moreover, the banking industry can handle the slight additional burden such liability would impose upon it. Just as there has been a growing recognition that professionals such as lawyers, accountants, and architects should no longer be insulated from liability for their negligence or breach of contract when certain foreseeable third parties are injured, so must courts break with the past and recognize that a bank's improper actions in dishonoring a check may injure a foreseeable third party. In seeking relief, such an injured party should be permitted to look to the bank that caused the injury.